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The Erosion of Annuity Values

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There, there, my precious cherub
Don't you cry;
You'll be an annuitant
By and by.

Experience with the conventional annuity indicates that "my precious cherub" has every reason to cry if he is to become "an annuitant by and by," and this is true in spite of the fact that the annuity promises an income "as sure as you live, as long as you live."

The life annuity, a risk-sharing plan participated in by a group of individuals all the same age, is an "upside-down" application of the life insurance principle. The savings of the individual members of the group are combined into a joint fund upon which each member can draw for life. Although the insurance company, like everybody else, does not know how long any given individual will live, it does know from applying the law of large numbers to the experience of previous annuitants approximately how many from a given group of persons will be alive at the end of each successive year. Therefore, the amount which each annuitant can withdraw annually can be calculated scientifically. The conventional annuity is a device for assuring that a given amount of capital will be sufficient to provide an *unchanging* and *regular dollar* income to the annuitant as long as he lives.

The Problem

To rely on a conventional annuity today as a method of building a retirement fund is to send a boy to do a man's job. To some readers, especially those who are engaged in selling annuities, this statement will seem much too strong; but to other readers, especially those who are trying to live on annuity incomes today, it will represent an accurate appraisal of the performance of annuities. Ignoring the sales pitch of those who try to sell annuities and the grumblings of those who try to live on the fixed dollar incomes provided by annuities, what are the facts? Is the conventional annuity really a quality product?

There is no doubt that the annuity has been dwarfed throughout the past decades, and that the dwarfing process has been a two-dimensional affair. *First,* the dollar amounts of annuity incomes guaranteed from a given initial capital investment have decreased sharply over the years; *second,* the purchasing power of fixed dollar annuity incomes has also decreased sharply.

Increase in the Cost of Annuities

A single-premium life annuity purchased today at age 65, male, yields a return of only 7.83 percent as compared with 11.26 percent 40 years ago, and 9.70 percent 20 years ago. The 7.83 percent, of course, is not all pure income. Most of it is a return of principal. For example, a 65-year-old man today can purchase a guaranteed lifetime income of $783 annually for a capital investment of $10,000. Accord-

ing to the United States Treasury Department, the $783 annual payment is divided as follows: $667 return of principal, and $116 interest earnings or investment gain. The breakdown is obtained by dividing the purchase price of the annuity ($10,000) by the life expectancy of the annuitant (15 years at age 65, male, according to the mortality tables used by the Internal Revenue Service). The resulting figure ($667) is considered to be a return of principal and the remainder ($116) is considered to be income and as such is subject to the income tax throughout the life of the contract. If the insured survives the 15-year life expectancy period and recovers all of his principal, the $667 payment becomes a pure insurance benefit (a benefit of survival) rather than a return of principal; and like most insurance benefits it is not subject to income taxes. The $116, however, continues to be taxed throughout the lifetime of the annuitant.[1]

The cost of annual-premium deferred annuities has increased even more than single-premium annuities. For example, 40 years ago, a young man age 25 could have purchased an annual-premium deferred annuity of $1,000 a year starting at age 65 for about $71 a year. In today's market the same annuity would require an annual premium of about $185.

What has accounted for the heavy decline in the number of annuity dollars guaranteed from a given capital investment? Why, for example, has the cost of single-premium immediate annuities increased more than 43 percent during the past 40 years? Why must we now pay $14,376 to purchase the same immediate annuity at age 65 which $10,000 would have purchased in 1916. Why has the cost of annual-premium retirement annuities increased even more? Why must we at age 25 pay $260 a year for the same annuity our grandfathers could have purchased for $100 — an increase of 160 percent?

Three elements enter into the cost of annuities, and changes have taken place in at least two of them which have materially reduced the attractiveness of annuities as a vehicle for funding a retirement income plan.

In the first place, people, on the aver-

[1] Since the Internal Revenue Service considers $667 a return of principal and $116 as income, the yield on an immediate life annuity would appear to be only 1.16 percent. But as anyone familiar with "annuitized" capital liquidation knows, the dollar amount of interest payment is not the same each year as is assumed in the Treasury formula. Periodic payments to annuitants are composed of three elements: interest, principal, and survivorship benefits. The interest element is highest during the early period of liquidation before the principal is heavily depleted. Although the interest assumptions used by insurance companies in computing annuity rates range from 2 percent to 3 percent (closer to 2 percent), the formula rate does not measure the true effective rate of return on the principal involved. This rate is reduced by the use of a loaded mortality table and an expense allowance. While the return is likely to be more than the 1.16 percent suggested by the Treasury Department, it is certainly far from attractive. For example, based on the mortality, interest, and expense assumptions used in the example given here, a man age 35 would receive a life annuity of only $36.86 a year for a $1,000 deposit. The 3.69 percent return includes liquidation of principal, survivorship benefits, and interest. This man could earn more by investing in a conservative income security and at the same time preserve his principal.

age, live longer.[2] Life expectancy has increased from slightly over 48 years in 1900 to about 70 years in 1955, an increase of about 46 percent in little more than half a century. In 1900 the chances of a young man age 18 reaching age 65 were even, one to one, but today the 18-year-old man has a two to one chance of reaching age 65. It is often suggested that mortality improvement has been the result principally of improvements in infant mortality rates; actually, however, less than 50 percent of the mortality improvement is attributed to this source. Recent studies indicate substantial improvement in life expectancy even after age 65, the normal retirement age. In 1900, the life expectancy at age 65, male, was 11.5 years. By 1940, it had increased to 12.1 years, and men who became 65 in 1955 had an average life expectancy of 14.86 years. Projections indicate that the male now 55 will have a life expectancy of 15.51 years at age 65. A man now 45 will have a life expectancy of 16.15 years at 65, whereas the 35-year-old man today should have a life expectancy of 16.75 years at age 65.[3] The average life span is expected to continue to increase because of improvements in medical science and improved income standards of the people.

Greater strides in America's program for improved medical care for all of its people should further increase life expectancy at all ages. Actuaries estimate that mortality rates will decrease at annual rates of 1.25 percent from ages 0 to 50; 1.20 percent at age 60; 1.10 percent at age 65; 0.95 percent at age 70; 0.75 percent at age 75; 0.50 percent at age 80; 0.25 percent at age 85; and 0 percent at age 90 and over. It is interesting to note that predictions of mortality improvements in the past have always turned out to be too conservative, so even greater improvement can be expected. Since annuities provide insurance against living too long, it follows that increased longevity raises the cost of annuities much as increased morbidity rates would raise the cost of disability insurance. The mortality picture is simply that more people are and will be living to age 65 to receive benefits and they are and will be receiving them for more years after age 65. The cost of providing a retirement income through annuities, therefore, will continue to increase unless offset by increased interest earnings, a not very likely prospect.[4]

This brings us to the second component of the annuity rate, interest earned on investments. Although over the past four years the trend in investment income has been upward, the 40-year trend definitely has been downward, moving from 4.80 percent in 1916

[2] Lest one get the wrong impression, it should be pointed out that the extremes in the total number of years people live are not necessarily increasing, but more people are living to be old. As it is put sometimes, the branches of the tree are not getting any longer but the apples are staying up there longer.

[3] The expected 16 percent increase in longevity at age 65, male, over the next 30 years will increase the net cost (no allowance for expenses) of a single-premium retirement annuity just slightly more than 10 percent, using 2.5 percent interest assumptions.

[4] Especially with respect to annual-premium deferred annuities, a small increase in the interest rate will offset a larger decline in mortality rates.

to 3.24 percent in 1955. The high during this period was 5.18 percent reached in 1923. The low was 2.88 percent reached in 1947. Since that year, the earnings have increased but are still materially under those of the 1920's and the 1930's. It is interesting to note that a difference of one-fourth of 1 percent in interest rates would result in an average change of about 6 percent in the cost of annuities.

The rates of interest quoted here refer to the net rate of interest earned on invested funds. For the most part, life insurance companies are restricted to fixed dollar investments: bonds and mortgages. They are allowed to invest only a small part of their assets in equities: real estate and common stocks. Over 80 percent of the life insurance business is written by companies licensed in New York. These companies must comply with the New York law which restricts investments in common stocks to an amount equal to the lesser of the following figures: (1) 3 percent of admitted assets or (2) one-third of the policyholders' surplus (paid-in capital, if any, and net surplus, including voluntary contingency reserves). Investments in real estate are limited to an amount equal to 10 percent of admitted assets for housing projects and 3 percent of admitted assets for any other type of income-producing real estate. The result is that the bulk of life insurance funds must be invested in assets which yield a conservative *fixed* rate of return. Thus life insurance and annuity policyholders are denied a real stake in the expanding economy.

The final component of the price of annuities is the cost of doing business. In recent years these costs have been higher than those in the 1930's but about the same as those in the 1910's and the 1920's. The cost of doing business does not appear to be a significant factor in the rise in annuity prices. Improved operating methods and the expanding use of business machines have enabled the insurance companies to handle over 150 percent more business over the past decade with less than a 50 percent increase in personnel.

Reduction in Annuity Purchasing Power

As annuity costs have moved up in response to mortality improvements and interest reductions, annuity values have declined under the impact of inflation. An example will illustrate the force of this impact.

Assume that an annuitant reaches age 65 today and is ready to retire. From an inheritance made available to him when he was 25 years old, he purchased a single-premium annuity, deferred 40 years, which now will pay him a lifetime income of $100 a month. In 1917, the year in which the annuity was purchased, an income of $100 monthly would have provided a reasonably comfortable living at retirement. But today, the contract will fall far short of fulfilling the purpose for which it was bought. Life at retirement will not be a "wonderful dream come true" as described in insurance company sales literature and advertising broadsides. Instead it is likely to border on a nightmare, especially for those who have relied on the annuity income alone.

What has happened to the value of

the annuity contract over the 40-year period? The dollar lost 60 percent of its purchasing power. It would take almost $250 to buy in 1956 what $100 would have purchased in 1917. An annuity purchased as late as 1926 would have lost about 35 percent of its purchasing power. An annuity purchased 20 years ago would have depreciated about 50 percent and one purchased just 10 years ago would today be worth only 72 percent of its original value. The difficulty in planning retirement with a quicksand type of instrument becomes readily apparent.

But on closer examination the experience with the deferred annuity over the past 40-year period has not been as bad as this illustration would indicate.

Retirement annuities generally are purchased on an annual-premium basis. This means that instead of depositing a lump sum 40 years ago at age 25 as illustrated in the foregoing example, the prospective annuitant deposits a fixed number of dollars each year for 40 years, after which he begins to receive a fixed number of dollars a month (or year) for life. Since the period of accumulation spreads over a large number of years, the effect of secular inflation on loss of purchasing power is somewhat lessened. In addition the advantage of pegging annuity income at the low cost of several decades ago in some cases has outweighed the disadvantages of inflation. For example, an annual-premium deferred annuity purchased in 1917 to begin in 1956 would show a favorable record even in face of the devastating inflation which took place during the 40-year accumulation period. The annuity premiums each year are based on the old rates, which are less than 40 percent of today's rate. This cost advantage of old contracts offsets the loss of purchasing power through inflation.

To illustrate — a $1,000 immediate annuity purchased today at age 65 would cost approximately $12,770. If the annuity had been purchased in 1917, on an annual-premium basis, the cost would have been $71 a year. The effective rate of interest necessary to accumulate $71 a year to a total of $12,770 would be 6.59 percent. This high rate of return is the result of the drastic increase in the cost of retirement annuities which took place between 1917 and 1956. The 25-year-old man who purchased the annual-premium retirement annuity in 1917 was able to retire at the 1917 annuity rates and values upon reaching age 65 in 1956. These rates and values, a matter of contractual rights, are unchangeable even though annuity costs have risen sharply.

But 6.59 percent does not measure the real rate of return. To ascertain the latter figure the annual contributions would have to be adjusted each year for changes in the price level. Only by using dollars of constant purchasing power can the real return on an investment be determined. Dollars which are not considered solely in terms of purchasing power unfortunately can lead one to a false sense of security.

When adjusted to 1956 price levels, the $71 paid in 1917 becomes $149.53. The adjusted premium in 1918 becomes $127.42 and so on. The following tabulation shows the real contributions

made each year by the annuitant in terms of 1956 prices.

Year	Dollars	Year	Dollars
1917	$149.53	1937	$133.44
1918	127.42	1938	135.88
1919	110.72	1939	137.94
1920	95.60	1940	136.78
1921	107.24	1941	130.26
1922	114.43	1942	117.55
1923	112.39	1943	110.72
1924	112.08	1944	108.95
1925	109.25	1945	106.55
1926	108.38	1946	98.24
1927	110.42	1947	85.79
1928	111.78	1948	79.70
1929	111.78	1949	80.49
1930	114.75	1950	79.70
1931	126.05	1951	73.81
1932	140.30	1952	72.19
1933	148.16	1953	71.62
1934	143.24	1954	71.37
1935	139.58	1955	71.68
1936	138.17	1956	71.00

The rate of interest necessary to accumulate these adjusted contributions to the $12,770 required to fund the annuity at 1956 annuity prices would be approximately 4.5 percent. Thus the increase in the cost of annuities was large enough to wipe out inflation losses and leave a net return of 4.5 percent in terms of real purchasing power.

A serious question arises at this point. What will happen to the real value of the fixed annuity income over the period of liquidation? How much will inflation eat into the value of the annuity income if the annuitant lives his expected 14.86 years? This no one can tell, but competent economists foresee continued inflation. Factors indicating inflation are (1) the arms race with the Soviet Union, (2) the acceptance by the major political parties of the responsibility for maintaining prosperity even if it means depreciating the dollar, (3) continued pressures for easy money policies, (4) continued pressures by labor for higher wages, and (5) an agriculture problem which seems to call for solutions involving government spending. Some economists are predicting an *average* secular price level rise of about 2 percent a year.

Solutions to the Problem

Life insurance companies naturally are concerned with the threat of inflation to the quality of their product. Chairman of the Board Ray D. Murphy of the Equitable Life Assurance Society of the United States recently said: "We cannot discharge our responsibilities by sitting idly by should government adopt policies which rob policyholders and annuitants of their savings . . . We cannot expect people to save and lend expensive dollars if they are likely to be repaid in cheap dollars."

A number of life insurance companies insist that the solution to the problem is to campaign for a stable price level. They argue that business and industry should be made to rely on individual and corporate savings rather than on inflationary bank credit to finance expansion. They contend that the interest rate should be left free to adjust the supply of and demand for loanable funds and that government policy should be directed toward maximum employment without inflation. In fact, they recommend that the Employment Act of 1946 be amended to add

the words "consistent with a stable price level."

Other companies appear to be more realistic. Although they do not approve of inflation, they realize that the inflationary threat is always present and believe that life insurance companies should meet this threat "head-on." As stated by President Louis W. Dawson of the Mutual Life Insurance Company of New York, "We live in what might be termed an 'age of improvement.' . . . the life insurance business has a public duty to improve its product and services in every possible way, and to conduct reasonable experiments with that end in view . . . I think we must maintain . . . a progressive and open-minded attitude, if we are to serve coming generations . . ."

This statement was made specifically in reference to the variable annuity, one of the most controversial developments in the life insurance business in recent years. The variable annuity is the brain child of William C. Greenough, Vice-President of Teachers Insurance and Annuities Association and author of *A New Approach to Retirement Income.*[5] The variable annuity was first issued in 1952 by the College Retirement Equities Fund under special enabling legislation in New York. The District of Columbia and West Virginia now permit the writing of variable annuities and variable annuity insurance companies have been formed in those two jurisdictions. Legislation is pending in other states and a number of life insurance companies are prepared to write variable annuities as soon as they get the necessary legislative green light.

What Is the Variable Annuity?

The variable annuity provides the annuitant with lifetime income payments of a varying number of dollars fluctuating in accordance with investment results. The assets behind the variable annuity are invested principally in fluctuating dollar investments such as common stocks and other equities. The value of these assets at the time of disbursement and the income they produce determine the number of dollars the annuitant receives in each income period. Apart from the equity principle of investment, the variable annuity contains the same feature of the conventional annuity: the systematic liquidation of capital over the lifetime of the annuitant.

The purchaser of the variable annuity buys *units* and not dollars when he pays his fixed annual premium. Each unit represents a share in the equity fund and its value is determined by the market prices of the securities held in the fund. The value of the unit naturally will fluctuate with the market. For example, during the first three years of the operation of the College Retirement Equities Fund the value of the unit fluctuated between \$9.59 and \$14.85. The number of units purchased by each premium deposit naturally depends upon the current value of the unit. If the deposit is \$50 and the unit value is \$10, the premium will purchase 5 units. If the value of the unit goes down, more units are purchased and if the value increases fewer units are purchased. Dividends

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[5] New York: Teachers Insurance and Annuity Association of America, 1952.

on the stocks are used during the accumulation period to buy additional units for the annuitant.

Suppose that by the time the annuitant reaches retirement age he has accumulated 300 units. The liquidation of these units will be based on the annuity principle. For example, according to the mortality tables the annuitant might be given an annuity of 25 units a year. The dollar value of these 25 units will vary year to year and will depend upon the fluctuations in both the value of the assets in the equity fund and the income from these assets.

The Prudential Life Insurance Company of America, a leading advocate of the variable annuity, has this to say on the subject of the basic desirability of the variable annuity: (1) the fixed dollar annuity is no longer considered fully adequate as a sole means of providing a lifetime income after retirement; (2) the difficulty is not with the annuity principle but with the inability of the fixed dollar annuity to reflect to any extent the changes in the purchasing power of the dollar; (3) a real public demand exists for an annuity which would have a reasonable chance of reflecting changes in purchasing power; and (4) the variable annuity is the best approach yet developed for meeting this demand.

The variable annuity principle assumes that stock prices and the cost of living will move in the same direction, thus giving the annuitant a fairly stable amount of purchasing power over a period of time. Economic studies, however, indicate that changes in the value of common stocks and changes in the cost of living are not perfectly correlated.[6]

The stock market is much more volatile than price levels are, and often a serious time lag in adjustments occurs. Factors other than inflation and deflation affect stock prices. Studies have also indicated that investment companies whose operations resemble variable annuities rather closely have not, historically, performed as well as the general market.[7] Therefore, even the most avid promoters of the variable annuity warn against committing all savings for retirement to variable annuities.

Appraisal of the Variable Annuity

As mentioned earlier, the variable annuity is a controversial subject in the life insurance business. Respectable experts appear on both sides of the issue. Those who oppose the writing of variable annuities by life insurance companies argue as follows:

(1) The variable annuity is not a scientific and foolproof way of maintaining a continuous and constant purchasing power and to offer it as such would result in disappointed policyholders and open the life insurance business to serious criticism. The variable annuity is being proposed in the middle 1950's after more than 15 years of war-inspired rising prices and expanding economic activity. Acceptance of the variable annuity might lead life insurance companies to abandon their fight against inflation and to give up

[6] See Greenough, *op. cit.*

[7] See J. Russell Nelson, "A Reconsideration of the Variable Annuity Theory," *Review of Insurance Studies*, Vol. 3, No. 2 (Summer, 1956).

the idea of the dollar guarantee as the fundamental principle of life insurance. Protection against inflation is best had by eliminating the causes of inflation rather than by treating its symptoms.

(2) For economic and psychological reasons, the dollar-averaging theory, which is supposed to reduce the stock market risks involved in the variable annuity, will not work. In depressions, when the market presumably is low and falling, people not only might be unable to keep up payments, but many of those who could pay might lose confidence in the face of falling stock prices and discontinue their payments.

(3) Users of life insurance and annuities are not prepared psychologically or financially to assume the risks of equity investments. The variable annuity lends itself to undue sales pressures and exaggerated claims. There would undoubtedly be some adverse fluctuation in the income received annually under a variable annuity and if the annuitant does not understand clearly the nature of his contract, any reduction in payments may cause him to be critical of his life insurance company.

The departure from fixed dollar guarantees coupled with the possibility of serious loss of principal might cause some people to question the performance of life insurance companies. Such companies have always been identified with certainty in dollar income, which certainty the public, rightly or wrongly, has learned to consider as absolute security. A drop in dollar income, regardless of a corresponding drop in the cost of living, is viewed as a real loss by a large segment of the public. A large part of the cost of living of retired people is fixed and cannot be exposed to a fluctuating dollar income.

(4) The variable annuity is a device solely for the promotion of the sale of stocks and a way for the life insurance companies to get into the securities business. Variable annuities are not really annuities but shares in open-end investment companies. Through such purchase of common stocks, life insurance companies will become owners as well as creditors of leading business corporations. They may thus be exposed to criticism and attacks suggesting that American business is subject to an undesirable concentration of control in the hands of the large life insurance companies.

In addition, the sale of variable annuities by life insurance companies will invite what the companies consider unwanted Federal regulation.[8] Concentration of economic power, manipulations of equity interests, and the use of life insurance funds in speculative operations are open invitations to Federal control.

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[8] The McCarran Act (March, 1945) contained a declaration that the continued regulation and taxation of insurance by the states is in the public interest. However, the Subcommittee on Antitrust and Monopoly Legislation of the Committee on the Judiciary, United States Senate, 83rd Congress, Second Session, 1955, stated: "To those individuals who abhor the thought of Federal interference with the business of insurance, who desire the continued regulation of the industry by the several states, the subcommittee has this final admonition: . . . this subcommittee will not forever accept 'attempts' at regulation as a substitute for regulation of the business of insurance by the States. The patience of the Federal Government with those who would abuse the good name of insurance may someday come to an end."

A number of these arguments are significant and cannot be ignored. Variable annuities are not foolproof: There is real danger that the dollar-averaging process might break down, some people who should not purchase variable annuities might be oversold on them, and life insurance companies could become involved in the concentration of economic power. But these objections can be eliminated by proper management and sale of variable annuities. This writer, however, cannot get excited over the "fear" of Federal regulation, the possible adverse effects on the reputation of the life insurance industry, the abandonment of the fight against inflation (which has not been very successful anyway), or the questionable argument that variable annuities are not annuities but shares in open-end investment companies.

In spite of the strong case that can be made against variable annuities, a number of sound arguments can be offered on their behalf. To this writer, the net balance appears to be in their favor. The case for variable annuities is based on the following points:

(1) When a man plans a retirement income program he should be interested in assured purchasing power, not in fixed dollars.

(2) The outlook is for continued inflation so that a conventional annuity will not give assured purchasing power. The so-called absolute security provided by conventional annuities is a sham. The long-run risk of inflation losses are at least as real as the long-run risks of the security market. The conventional annuity is likely to be more variable than the variable annuity when measured in terms of purchasing power.

(3) The variable annuity will provide at least some safeguard against depreciating purchasing power. Common stocks have provided a good hedge against inflation in the past and are likely to do so in the future. The variable annuity is preferable to shares in investment companies since annuities make it possible for the average man, whose accumulated investments are not large enough to enable him to live after retirement solely on investment income, to liquidate his capital under the annuity principle. In spite of the fact that the stock market and the cost of living do not move exactly together, the variable annuity undoubtedly would keep the purchasing power of annuity income somewhat more closely related to long-term changes in the general price level than would be the case with fixed-income annuities.

(4) The variable annuity would enable the annuitant to participate in the secular growth and increasing productivity of the country. Since both the pay-in and pay-out periods may extend over a long period of years, this can be an important consideration.

(5) Funds invested exclusively in fixed-income obligations have little opportunity for gains to offset investment losses. Equities, offering some chance for appreciation, could balance losses against gains.

(6) Aside from the question of the possibility of appreciation, equity holdings should yield a higher annual income than fixed income investments. Under normal market relationships, div-

idend yields generally are higher than the interest yields from high-quality fixed-income obligations. Furthermore, improvements in technology and the reinvestment of corporate earnings provide a growth factor in equities which can lead to substantial increases in dividends over the years.

Conclusions

There is no doubt (1) that the conventional annuity has increased in cost to such an extent as to make its attractiveness debatable and (2) that the purchasing power of the fixed dollar income of conventional annuities has suffered severe setbacks and continues to depreciate. The variable annuity offers some relief on both counts: (1) One of the principal causes of the increase in the cost of annuities has been the decline in interest earnings. Life insurance companies are earning only 3.24 percent on the admitted value of their assets (less on the market value). The greater freedom of investment which the variable annuity offers should allow life insurance companies to improve their investment results appreciably. The attractiveness of the variable annuity does not rest entirely, therefore, on its function as an inflationary hedge. (2) Even though the various indexes selected to show the rough correlation between stock performance and the cost of living are open to question (like all indexes), there is no serious question that an annuity based on common stocks will, on the average, give a more nearly steady purchasing power than one based on fixed-value securities.

The fact that the variable annuity is no panacea for the problem of retirement planning is not a reason to let the idea die on the vine. The built-in inflationary bias[9] in our economy makes it necessary to seek methods of funding retirement benefits which in some way reflect changes in the cost of living. The variable annuity, intelligently used, accomplishes this job better than any other device yet developed.

Some economists see strains and stresses in the economy today which point to a decline. Of course a major depression is possible, although unlikely. Even so, the possibility of a major depression is not a good argument against the variable annuity. The variable annuity is not a short-run speculative device but a long-run investment program. Short-run shifts in the economy are unimportant since retirement income planning is a long-range problem — 47 years on the average for a man now age 35. It is unrealistic to assume that prices will be stable throughout this period. The problem is to give the old-age planner some security no matter how the economy goes.

Reference has been made in this article to the variable annuity *if properly or intelligently used.* No one should base his entire retirement program on the variable annuity. Dr. William C. Greenough after studying a large amount of historical data concludes that "a retirement plan [whereby contributions] are invested partly in debt obligations and partly in common stocks

[9] The bias consists of heavy defense expenditures, escalator wage clauses, budget deficits, parity prices, subsidies, cost-plus contracts, government financing with bank credit, welfare provisions, and the feeling in some high places that stable prices and full employment are incompatible.

. . . offers promise of supplying retirement income that is at once reasonably free from violent fluctuations in amount and from serious depreciation through price level changes."[10] A combination of conventional and variable annuities seems to be the safest approach to a secure retirement program. A good balance between the two can eliminate much of the speculation in planning a retirement program. In achieving a balance, such influences as social security coverage, industrial pension rights, home ownership, and the like should be considered. The safest combination, however, is a matter of hindsight, not foresight. The current vogue is to recommend a 50-50 split between variable and conventional annuities.

There is a definite need for variable annuities. Life insurance companies seem best equipped to offer them. If the insurance companies and others who oppose the variable annuity succeed in blocking enabling legislation in the major states, then some other financial institution should be allowed to write this form of insurance. The need is too great for the idea to be restricted to a few specialty companies in a few states.

[10] *Op. cit.*, pp. 13-16.

Some Questions and Fallacies Concerning Automation

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THE PROBLEM of automation is potentially one of the most challenging of the many problems confronting our economy.[1] Fears have been voiced, particularly by labor groups, that automation may bring widespread unemployment.[2] Other voices have derided such fears.[3] It may well be that our economy will take automation in stride. It may not, however. If the latter possibility becomes an actuality, it would be well for us to do some preparatory economic thinking and planning before we are faced by emergency conditions. A wise general, however confident of victory, secures his retreat.

The major potential problems of automation to be considered here are two, namely, its possible effects on employment and its implications, both ethical and practical, for distribution of the product. These two problems cannot be completely separated from each other, of course. The writer accepts the fact that automation is here, or just around the corner, for a sizable segment of our economy, and believes that it contains a long-run potential for economic good (assuming that economic good consists of obtaining more production with a smaller expenditure of human effort and natural resources). But, as in the case of morphine, automobiles, and atomic fission, all of which contain potentials for good, the writer feels that uninhibited and unthinking

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[1] A rigid definition of the term is not necessary for the consideration of the possible problems of automation. The unusual of today may be the commonplace of tomorrow. At its highest levels, present-day automation involves a self-adjusting type of performance control which anticipates requirements and makes the necessary adjustments. At lower levels, it may involve only a signal response requiring human corrective action, or a self-adjusting control exercised after or during the performance of operations. From a practical point of view, perhaps, automation can be thought of as mechanization or performance control at a level considerably higher than that now existing in a particular industry, rather than at any absolute level. Cf. James R. Bright, "How to Evaluate Automation," *Harvard Business Review,* July-August, 1955, pp. 101-11, and A. Stuart Hall, "The Ancestry of Automation," *Current Economic Comment,* August, 1956, pp. 3-9.

[2] For some recently published examples of organized labor's opinions on the coming impact of automation, see O. William Blaier, "Will Automation Wipe Out Your Job?" *American Federationist,* December, 1955, pp. 28-29; *AFL-CIO News,* February 4, 1956, p. 2, March 17, 1956, p. 8, and June 15, 1956, p. 7; *Oil, Chemical and Atomic Union News,* February 6, 1956, p. 3, and September 24, 1956, p. 2; and *United Automobile Worker,* October, 1955, p. 2, and August, 1956, p. 10.

[3] In view of the considerable amount of excellent technical literature available, especially in engineering and management publications, this article does not discuss the probable scope of and rate of introduction of automation. Readers wishing information on this subject will find a useful bibliography in *Source Materials on Automation and Related Subjects* (74 pp.) compiled by the UAW-CIO Research and Engineering Department Library, April, 1955.

introduction and utilization of automation may also possibly be extremely hazardous.

Much serious writing about the economic impact of automation today is from the ranks of management or from management-oriented individuals who are attempting to justify introduction of new methods and to calm the fears and doubts of labor and the general public.[4] In doing this, two main arguments are used by management. First, the production and servicing of automation machines will create new high-paying jobs. Second, we have gone through this process before without serious difficulty; that is, automation actually has been around for a long time and the emphasis being placed on its development now is only a matter of degree. For example, a prominent industrialist has presented statistics purporting to show how new machines have made more jobs instead of fewer in various industries, and has said "There is nothing new about automation except the word itself."[5]

Displacement Effects of Automation

I.

The argument that actually the present workers displaced by automation will be replaced by an equivalent number of workers engaged in producing and servicing the new machines, and presumably at higher rates of pay, is at least an extremely debatable assumption. If as much effort and resources (costs) per unit of output for a given production are to be used in producing, servicing, and operating the new machines as formerly went into producing, servicing, and operating the old (that is, if the gains of lower direct operating costs are to be offset by higher costs from other sources), what motive does a cost-and-profit-conscious manufacturer have for automating his plant? The principal advantage of automation, presumably, is that it does reduce costs!

As is often the case when reasoning alone is not convincing, masses of statistics are quoted supporting the proposition that new methods create additional jobs. The classic example used is the replacement of the buggy by the automobile. This "horse-and-buggy fallacy" ignores the fact that the development of the automobile industry was based on a *new consumer product,* not on a new method of producing an old one. The recent development of the

[4] For typical examples, see: National Association of Manufacturers, *Calling All Jobs — An Introduction to the Automatic Machine Age,* November, 1954; John Diebold, "Automation — Its Impact on Human Relations," an address before the Congress of American Industry, published in *Developments on the Labor-Management Front,* National Association of Manufacturers, December, 1954, pp. 32-39; "Why Have Push Button Factories?" First National Bank of Akron, *Business Analysis,* January 15, 1955; Peter F. Drucker, "The Promise of Automation," *Harper's Magazine,* April, 1955, pp. 41-47; and Council for Technological Advancement, *Automation and Job Trends,* October, 1955.

Some other serious writing, of course, is appearing in specialized economics journals. This specialized material, however, is not likely to be encountered by many economists interested primarily in other specialties or by "general" economists.

[5] Benjamin F. Fairless, "Tomorrow's Technology: Master or Servant?" *Management Review,* April, 1955, pp. 210 ff.

Both Diebold and Drucker, in the articles cited in n. 4, use the word "revolution" rather than "evolution" in speaking of automation, however.

television industry, which certainly has opened up new vistas of employment for wrestlers and assorted vaudevillians, has been based upon the exploitation of a *new consumer market* for wrestling and vaudeville and not necessarily upon different forms of these two arts. Additional jobs, in the final analysis, are dependent either upon new consumer products or upon new markets for old products, and *not* on new methods of making old products.

If a new buggy-making method, allowing one man to produce as many buggies as formerly were produced by one hundred men, with a consequent saving in costs, had been developed two generations ago, would we today have a giant General Buggies Corporation, employing well over a half-million persons, competing with a giant Ford Buggy Company, a Chrysler Buggy Corporation, and assorted other buggy makers? Probably not! Or would television sales, and the employment of wrestlers, have reached present heights if only ringside fans had purchased sets? How many historical examples can be cited where a new production method has created additional jobs (that is, more jobs than were abolished) without either creating a new consumer product or tapping a new consumer market? Such innovations as Whitney's cotton gin and Ford's mass-production techniques are examples of new consumer markets for old products. In these cases, substantial cost reductions were passed along, in part at least, to consumers whose demand was relatively elastic. New markets still may be tapped as a result of price reductions, of course, but we have little assurance, either from logic or from historical experience, that lowered prices will be forthcoming automatically as an immediate result of lowered production costs or that lowered prices would automatically result in substantial consumption increases in all cases. Nor does automation in itself, so far as can be seen at present, appear to offer many new consumer products.[6]

II.

Employment in the economy can be maintained only if enough consumer purchasing power and investment spending to absorb the economy's output are generated by the production process. If the widespread introduction of automation makes it possible to increase production greatly with relatively fewer man-hours of labor (and otherwise there is little point in adopting it), what effect will this have on consumer purchasing power?

We have learned from experience that, contrary to classical economic doctrine, supply does not necessarily create its own demand. Fewer man-hours means lower aggregate labor costs (or a smaller labor income), which, of course, means higher payments to other factors of production in the form of profits, interest, or rents (assuming the absence of equivalent price reductions). It is well known that lower income groups (laborers) spend a larger proportion of their income for consump-

[6] In a limited number of areas, such as the aircraft ball bearings and the petrochemicals fields, for example, automation does make possible products which could not be produced otherwise. Such products are mainly for industrial rather than for direct consumption use, however, and do not appear to be of significant quantitative importance in the over-all economic picture.

tion purposes than do the higher income groups which are more dependent on property incomes. A Whizzmobile manufacturer can drive only a limited number of Whizzmobiles. If aggregate wage income is decreased, then obviously, aggregate consumer spending will likewise decrease, with a consequent threat to employment.

The contention that new investment spending and indirect labor costs induced by the introduction of automation will offset lowered direct labor costs, and thus counterbalance unemployment by the creation of new or additional jobs, was considered earlier in part, and seriously questioned. A more thorough look at automation might provide an additional basis for questioning this contention. It may be that automation in many cases will prove to be a capital-saving as well as a laborsaving innovation. Although the initial cost of automation machines may be higher than that of present machines, the savings in space and safety devices, better quality control, and a greater lifetime output of the new machines may actually permit a smaller total capital investment for a given output in some instances than do present machines. If so, we have a double threat of lessened employment.

In view of the certainty that automation will require fewer man-hours in direct production, the high probability that additional man-hours required for servicing will fall considerably short of offsetting the fewer hours required for operating, and the possibility that even less over-all investment in plant and equipment for a given output may be required with the new methods, is it altogether realistic to expect the production process to generate enough demand to absorb its potential output? Can we lift ourselves by our bootstraps? Or are we deluding ourselves by wishful thinking based on classical economic premises of the early nineteenth century?[7]

III.

The second "management" argument, that we have gone through this before, and that the emphasis placed on today's and tomorrow's automation differs only in degree, has more apparent validity. We have long been familiar with such examples of "automation" as thermostat-controlled furnaces and automatic telephone switchboards. Using the same line of reasoning, however, we could say that the difference between a firecracker and a hydrogen bomb is only a matter of degree, as both are explosives. But is it realistic to lull ourselves with this "firecracker fallacy"? The so-called industrial revolution of the eighteenth and nineteenth centuries, which in the same sense could be called a matter of degree, brought problems of social readjustment and class divisions which created wounds as yet unhealed. Al-

[7] A widely used modern elementary economics textbook, in discussing the effects of new products and processes, says ". . . some scientific discoveries can have a harmful effect on employment and purchasing power, both in the long run and in the short run . . . there is no automatic principle of compensation which guarantees that technological change will produce a *sufficiently* favorable effect on purchasing power, or even any favorable effect." Paul A. Samuelson, *Economics*, 3d ed. (New York: McGraw-Hill Book Company, 1955), p. 214, n. 1.

though most of us probably would agree that the ultimate outcome of this earlier industrial revolution was economically beneficial, do we wish to go through a similar turmoil again, perhaps on a larger scale, to make interesting reading for students of economic history in the twenty-second century? Or do we want to bring the practice of our social science nearer the level of our physical science and engineering technology and get the benefits of the "new" industrial revolution without running the risk of getting the harmful effects of the old?

IV.

It is usually admitted, even by its most ardent proponents, that automation will cause some human relocations. But it is frequently maintained in the same breath that these disturbances will be only temporary adjustments which will work themselves out in the long run.[8] We live in a series of short runs, however, and this "equilibrium fallacy" is unlikely to comfort the individual who is forced to watch his family suffer because he has been "temporarily adjusted" out of his job by a "robot." Technological unemployment, when it exists, cannot be assumed away. It has even been asserted that ". . . the life expectancy of almost any occupation is greater than that of the workers engaged in it."[9] Such a statement, if it were not for the "almost" qualification and the fact that history is filled with contrary examples, would be comforting!

It is possible, of course, that a rapidly expanding economy, such as we have seen in recent years, might be able to absorb most of the workers displaced by automation. But is it wise to depend upon this? What assurances do we have that this unprecedented rate of expansion will continue indefinitely? In case of a recession, or a less rapid rate of expansion, will we come to the point of subsidizing industrial employment by buying up its surplus product and storing it in government warehouses as we do at present with surplus agricultural commodities? One is certainly no more absurd than the other! Or must we expect that our monetary and fiscal apparatus will perpetually absorb potential technological unemployment?

There may even be grounds for believing that we will be faced with a labor "shortage" during the next two decades. If such a shortage occurs, though, it is likely to be one of highly skilled personnel.[10] But what are we going to do with our great body of present-day unskilled and semiskilled workmen who are likely to be most severely affected by the impact of automation? Shall we not take constructive preventive action while there is still time for it?[11]

[8] See Drucker, *loc. cit.* The same viewpoint is expressed or implied in most of the references cited in n. 4 and in a large group of similar works.

[9] Council For Technological Advancement, *op. cit.*, p. 16.

[10] See Peter F. Drucker, "The Coming Labor Shortage," *Harper's Magazine*, March, 1955, pp. 27-32.

[11] An example of union action designed to convert semiskilled machine tenders into electronic technicians by four years of night classes is described in *Time*, December 5, 1955, pp. 51-52.

What Might Be Done

I.

Labor is, and always has been, properly concerned with the effects of new laborsaving methods, not because it necessarily dislikes new methods as such but because it fears the effects of new methods on established patterns of income distribution. History contains many examples of machine-breaking and other more sophisticated delaying tactics, but it shows, also, that such tactics have always failed to prevent adoption of the new devices. Such futile efforts remind one of the late cartoonist Bud Fisher's Jeff, attempting to stop his automobile by dragging his feet on the highway. This "foot-dragging fallacy" frequently is expressed by labor-management negotiations leading toward a gradual controlled introduction of new methods. Although such policies may often be desirable from some social viewpoints, they are costly from the economic point of view because they prevent the most efficient (least cost) combination of productive resources.

Instead of attempting to keep the pie small and follow a *status quo* slicing procedure, it would appear in general to be more beneficial to society as a whole to enlarge the pie as much as possible and at the same time slice it in as equitable a way as can be devised. In addition to the economic and social costs of less efficient production and of prolonging the agony of inevitable change, we must also realize that our position of world industrial leadership conceivably could be challenged by competitors not afraid to adopt more efficient production methods.

II.

Labor unions, like other, political organizations, may at times be inclined to follow the motto "If you can't lick 'em, join 'em." Labor today is in a unique position to force such a joining. Thus, we have labor-management negotiations involving guaranteed annual wages, annual productivity increases, or other innocent-sounding phrases which sometimes disguise the basic fact that such negotiations are actually conferences to determine in what way the proceeds of more efficient production methods are to be split.

Management in these negotiations theoretically represents the owners. In reality, however, management is under constant pressure from nonowner groups whose interests may often conflict with the interests of owners. One of the most potent of these groups is organized labor. Management has to live with labor from day to day, but its owner contact occurs only once a year when proxies are solicited. Owners generally are widely scattered, unorganized, incoherent, and know little of what is going on within the large corporation (and, usually, care less as long as this year's dividends are as high as last year's). Under such circumstances, then, it is not hard to imagine the working of a "conspiracy theory of wages" where (after a good outward show of resistance) management in some situations might be inclined to seek to maximize its own tenure in office by surrendering all or most of the gains of increased productivity to its labor force in return for labor peace which will enable the firm to pay its

customary dividend by continuing to sell its product at the customary price. Not all bureaucrats are working for the government![12]

We need not at this point concern ourselves about the effects of this method of operation on investors. Two other groups may be deserving of consideration from the over-all social and ethical viewpoint, however. These groups are the general consuming public (which includes investors) and the workers in non-automatized industries (also a part of the public), neither of whom has any semblance of representation at the bargaining table.

Is it in accordance with our ideas of economic and social justice that only the workers who are fortunate enough to get on or remain on the payroll in those industries where it is technically and economically possible to automatize are to benefit from the introduction of more efficient production methods? Or would we rather see consumers as a group benefited to some extent through lowered prices? Under present conditions in much of our industrial structure, competition may no longer be sufficient to protect consumer interests by forcing prices down (if it ever was). Not only is competition in many of our largest industries confined to a relatively small number of large firms, which is a far cry from the competitive model of the early classical economists and their anachronistic present-day disciples, but each of these large firms is making virtually the same agreement with the same union. If the union is strong and alert, productivity benefits probably cannot be passed along to consumers by price competition even though management may desire to do so.[13]

Assuming that labor is entitled to some share in the proceeds of increased productivity, through higher wages, shorter hours, or fringe benefits, why should these proceeds be confined to those laborers who happen to be employed in industries subject to automation? Obviously many industries can never, for technological reasons, automate to any considerable extent.

If our social and economic organization is such that a large number of individuals cannot contribute to production to the fullest extent of their abilities, even though they may be perfectly willing to do so, can we in justice economically penalize these persons and their families? Or does society have a moral obligation to reward them (much as we do our armed forces during peacetime) for being ready, able, and willing to perform even though their performance is not required? We have various social benefits (however inadequate they may sometimes appear) for individuals who are unable to make a productive contribution, and we even go so far as to pro-

[12] This situation would not necessarily decrease aggregate consumption, but would result in what might be called an "unearned increment" going to one group of consumers, namely, the laborers concerned.

[13] For a concurring opinion, see Prof. Clyde E. Dankert's *Technological Change — Who Gets The Benefits?* (Amos Tuck School of Business Administration, Dartmouth College, January, 1955), which in discussing technological change concludes (p. 2) that "There is a strong basis for believing that an increasing share of the monetary gains resulting from these improvements will go directly to the workers in the form of higher money (and real) wages."

vide unemployment insurance for those who are able and willing but are temporarily denied an opportunity to produce. But what do we have for those who possibly may be forced to produce at a level considerably below their capacity? And how much consideration have we given to the possibility that as a result of automation we may have to live more or less permanently with a considerable amount of unemployment or of underemployment of human resources?[14]

III.

We have no alternative regarding the installation of automation. It is here, and is being and will continue to be installed. We do, as yet, however, have a choice as to whether this installation will proceed in an orderly, efficient, and equitable manner, or in some less desirable fashion. Basically the problem resolves itself into one of the distribution of the product, and economics conceivably could be on the verge of shifting from a "science of the production of wealth" back toward its older concept of a "science of the distribution of wealth." Physical scientists, engineers, and management officials have production techniques well in hand, but distribution, both in theory and in practice, is lagging far behind. The final decision regarding distribution of the product must be made by society as a whole, of course. But economists and business leaders must take the lead by pointing out the various distribution alternatives and their possible or probable consequences, or they must surrender a large portion of their claims of being useful members of modern society.

The probable economy-wide impact of automation is a subject peculiarly within the province of economic analysis. But too many economists, unfortunately, seem prone to seek solutions for problems only when the problems are thrust into their laps, or after solutions already have been reached by "practical" people who cannot wait for "theories." At present, the automation situation still is fluid enough that a little time for serious study remains before its problems are "solved" by management, labor, and government. The greatest automation fallacy of all, so far as the general economist is concerned, is the "ostrich fallacy" of comfortably ignoring the present and prospective problems of automation by continuing to concentrate on the problems of the past rather than on those of the future.

IV.

In solving the distribution problems possibly to be created by automation, we may have to abandon or drastically modify both our major competing ethical distribution standards, the Parable of the Talents[15] (Christian Capitalism), which rewards according to contribution, and the Parable of the Vineyard[16] (Christian Socialism), which rewards according to need. In deciding who is to get what, we may have to consider not only the over-all size of the pie, actual contributions

[14] In this context, a person may be considered underemployed if he is prevented from working the full prevailing workweek at the prevailing rate of pay in the area of his greatest productive efficiency.

[15] Matthew 25: 14-30.

[16] Matthew 20: 1-16.

to its filling, and need for its nourishment, but we may in addition have to give some recognition to willingness and ability to contribute. And even when we have decided what the distribution is to be, there still remains the details of how the distribution is to be accomplished in the most efficient and frictionless way; in other words, what part shall be played by the various types of direct and indirect distribution methods now in use or capable of being devised.

In summary, the coming of automation, along with its undeniable benefits, possibly brings serious problems of chronic technological displacement and maldistribution. Although our handling of these problems (if they actually arise) during the next few years may influence our well-being for decades to come, as yet little serious consideration has been given to them except by "specialists" in the field of economics or by particular groups (representing organized labor or management) with axes to grind.

The writer obviously does not have the answers to the questions raised here. He feels, however, that workable answers can be reached, both in terms of goals and methods, once we set to work on the problem. Edgar Allan Poe once remarked that a human mind cannot devise a puzzle which another human mind cannot solve. Let us hope that the poet was not too optimistic.

The Tax Rate Limit Controversy in Illinois[1]

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PRIOR TO 1946 real estate in Illinois was assessed far below its full value by local assessing officials despite the existence of a 1927 law requiring full value assessment. This practice inevitably resulted in inequities between counties since similar properties were assessed at varying proportions of full value. In 1945, however, the law was amended to make it compulsory for the Department of Revenue to equalize property assessments of counties at full value in the event that this was not done by county assessing officials.[2]

The initiation of this new 100 percent assessment program meant that existing rates would be applied against a much higher tax base, since before the passage of the new law property was being assessed at ratios which varied from 14 percent to 68 percent of full value. This meant then ". . . that all Counties would be enabled to greatly increase their tax extensions without exceeding their tax limits."[3] To ease the burden on the taxpayer the General Assembly reduced most tax limits by one-half.

The end effect of the full value assessment program when coupled with the one-half reduction in rate limits was to give counties with assessment ratios below 50 percent increases in their tax revenue while at the same time reducing the amount of taxes receivable by counties with assessment ratios above 50 percent. To meet this problem the effective date of the new rates was delayed until January 1, 1951, and a special formula was devised to limit the extension of rates during this "transition period" for all taxing districts with a population of less than 500,000.[4]

The passage of the full value assessment amendment combined with the creation of formula provisions for the purpose of determining equitable rates triggered a continuing controversy be-

[1] The reader may find information on the variety of tax rate limitations which have been used in other states by referring to Rodney L. Mott and William Suiter, "The Types and Extent of Existing Tax Limitations," *Property Tax Limitation Laws,* edited by Glen Leet and Robert Paige (Chicago: Public Administration Service, Publication No. 36, 1936), pp. 41-47. Other articles on tax rate limits may also be found in that publication. An excellent summary of tax rate limits as well as additional literature on the subject may be found in Vernon Morrison, "Property Tax Limitation," pp. 118-22 and 131-36, *passim, Report of the Revenue Laws Commission of the State of Illinois* (1949).

[2] Ch. 120, Sec. 627, *Illinois Revised Statutes* (1945).

[3] Morrison, "Property Tax Limitation," *loc. cit.,* p. 119.

[4] In effect this meant that the Cook County government and the various taxing bodies within Chicago, many of which were controlled by "peg levies," were exempt from the act but not the smaller taxing districts outside Chicago. Other exemptions from the act included tax limits stated in dollars or limits where minimum qualifying tax rates were necessary in order to receive state aid.

tween two diametrically opposed groups concerning the application of rate limits by local governmental units. One group maintained that after a brief transition period the prerogatives of rate fixing should be returned to the local governments. The other group vigorously asserted that such freedom, especially when combined with the full assessment program, would unfairly burden the already harassed property owner. It is the purpose of this paper to trace the effect of the controversy over the methods of establishing rate limits in local Illinois governments.

Provisions of the Formula

Part one of the formula attempted to assure counties with high assessment ratios sufficient revenue to carry on their normal activities by providing that no rate limit should yield an amount less than the ratio of assessed value to full value in 1942 times the 100 percent full value for the current year times the legal 1945 tax rate limit. The year 1942 was used as a base throughout the formula since it was considered ". . . a year when tax rates, assessable values and financial needs of taxing districts were on a fairly normal basis."[5] Specifically, however, it was probably used as a norm to protect taxpayers in governmental units in Cook County (other than Chicago and Cook County citizens) from the drastic increases in the assessment which occurred after 1942. For example the ratio for Cook County and Chicago in 1942 was 31 percent but in 1943 it rose sharply to 75 percent of full value.[6]

Part two of the formula, on the other hand, attempted to place some sort of upper limit on tax rate extensions by counties with low assessment ratios. Thus during the interim period, unless changed by referendum, 15 percent was the largest proportion by which any tax rate might exceed the product of the 1942 ratio of assessed to full fair cash value times the maximum tax rate limit effective for the levy and assessment year 1942. An additional provision attempted to restrict any tax extension increase in any one year to 5 percent of the maximum extendible in 1942.[7]

The latter proviso caused a great deal of uncertainty regarding the limit which actually applied in such instances. Did this clause limit tax rates to 105 percent of the maximum tax extendible in 1942 or did it imply instead that 5 percent of the latter could be added to the tax determined by the formula even if such tax exceeded the maximum of 1942? In 1947 the Illinois Supreme Court, after first declaring the formula provisions constitutional, decided in favor of the latter viewpoint and noted that interpreting the law so that no tax could be more than 105 percent of the maximum extendible in 1942 ". . . is in effect to hold that in certain taxing districts the amount of tax . . . [levied] is to be determined on values of 1942 . . . without regard to

[5] *Grace Anderson* v. *The City of Park Ridge et al Appellees,* 396 Ill. 235 (1947), p. 253.

[6] Taxpayers Federation of Illinois, *The Illinois Taxpayer,* Vol. 6, No. 7, p. 5.

[7] Ch. 120, Sec. 643a, *Illinois Revised Statutes* (1945).

any increased valuation that may have been added since that year."[8]

House Bill 513: 1947

The court's interpretation undoubtedly increased the amount of taxes which could be levied beyond the intent of many groups vitally interested in more restrictive rate limits.[9] As a result the 65th General Assembly in 1947, in addition to extending the transition period through December 31, 1952, revamped the rate limitation features of the General Revenue Act so that rates for taxing jurisdictions of less than 500,000 had to be computed according to the lesser of these amounts:[10]

a. $\dfrac{105\% \times \text{1942 assessed value} \times \text{1945 maximum rate}}{\text{1942 full value}}$

b. $\dfrac{105\% \times \text{1945 assessed value} \times \text{1945 maximum rate}}{\text{1946 full value}}$

The new formula held ". . . the affected taxing jurisdictions rather closely to their pre-1946 utilization of the property tax . . . [and] as the dollar need for government revenues rose, numerous units and funds reached their tax limits. Many jurisdictions where demand for services increased but property values lagged, found the new limits restrictive. Confronted with such restrictions many jurisdictions, particularly school districts . . . made successful use of referenda to gain increases in tax rate limits."[11]

The *Kremers* Case

As has been noted, the period of fixing rates by a formula had originally been thought of as a temporary expedient to allow taxing districts to make the necessary adjustments to the problems brought about by the full value assessment program. Indeed, a definite termination date was provided for in the initial rate limitation law. Yet when that date was extended to December 31, 1952, by H. B. 513 of 1947 some organizations made it quite clear that ". . . not later than the 1951 session of the General Assembly, either some new protections for the property taxpayers will have to be enacted by the General Assembly or the provisions of H. B. 513 will have to be extended in time . . . [otherwise] the lid will be off in taxing power after that date."[12]

The issue was brought to a head in 1950 by the case of *Kremers* v. *the City of West Chicago* (406 Ill. 546). In this instance a rate limitation law which

[8] *Anderson* v. *Park Ridge, loc. cit.*, p. 253.

[9] *The Illinois Taxpayer, op. cit., passim.*

[10] Other exemptions from the provisions of this act included the tax rates of districts created after January 1, 1946; tax rates established by referendum after January 1, 1946; and tax rates which by statute were made exempt from the provisions of the Revenue Act such as the town fund and the bond statutes. Furthermore, the provisions of the formula could not limit levies below the amount necessary to receive state grants for general assistance, tuberculosis control, equalization aid for educational purposes, and motor fuel tax funds.

[11] Morrison, "Property Tax Limitation," *loc. cit.*, p. 126. For a further commentary on the effect of the formula see Jack Isakoff and Gilbert Steiner, *Illinois Municipal Revenue* (Urbana: University of Illinois, Institute of Government and Public Affairs, 1953), pp. 177-89, *passim.*

[12] *The Story Behind Your Tax Bill,* Taxpayers Federation of Illinois (Springfield, May, 1948), p. 15.

specifically attempted to make permanent the 1947 temporary rate limits for library purposes was declared unconstitutional. The court decided that the library tax created ". . . a classification that is inherently arbitrary and not based upon any reasonably conceivable set of facts, as certain cities with approximately the same population and burdened with the same responsibility and demands upon their library building funds have a different tax-rate limitation under its provisions than others, thus establishing dissimilarity in the powers and methods of different cities in the levy and collection of taxes, in violation of Section 22 of Article IV of the constitution."

The decision, if applied broadly, meant that permanent tax rate limits fixed by formula could not vary among governmental units of similar population and characteristics. Since rates set by formula during the transition period had this effect, the possibility of making them permanent was at least of questionable constitutionality.

Hodge-Downing Amendment

To meet the court's criticism the General Assembly in 1951 passed the so-called Hodge-Downing Amendment which provided that the formulas lapse after December 31, 1953, and that the ". . . maximum tax rate limitation for each fund of each taxing district be established locally or by the votes in each taxing district . . ."[13]

However, the means of establishing such rate limits were prescribed in terms sufficiently indefinite to cause confusion regarding their intent. Thus the law provided that:

1. Every corporate authority whose rate limit was subject to the Revenue Act, except townships, could by resolution or ordinance passed not later than December 31, 1951, establish "the maximum permissible tax rate limitation that . . . [could] be extended thereafter."[14]

2. The rate established went into effect immediately as long as it was not ". . . greater than the tax rate limit in effect for said fund as of the date of adoption of the ordinance or resolution."

3. If the governing body of a city, village, or incorporated town established a corporate fund rate up to 10 percent greater than "the maximum rate in effect for said fund" as of the date of the adoption of the ordinance or resolution, then a petition by 5 percent of the electors or 1,000 of the eligible voters — whichever was less — could force a referendum on the increase. However, no city, village, or incorporated town which increased its corporate rate by a referendum passed after January 1, 1946, could increase its rate under these provisions.

4. In the event that a governmental unit did not pass a resolution or ordinance by December 31, 1951, ". . . the maximum tax rate for such fund . . . [continued] to be the maximum tax rate in effect for that fund on December 31, 1951 . . ."

5. Any maximum tax rate established

[13] Ch. 120, Sec. 643b, *Illinois Revised Statutes* (1953). As under H. B. 513 of 1947 taxing jurisdictions of more than 500,000 population, town funds and bond statutes were exempt from the provisions of the Hodge-Downing Amendment. Again the formula could not limit levies below the amount necessary to receive the various state grants. In addition, through court interpretation and legislative action, city library funds, school districts subject to Article 17 of the School Code, and police pension funds are now exempt from the act.

[14] In the case of townships, the town board submitted the rate which they adopted to the electors for their approval at the April, 1952, town meeting.

can be increased by referendum as long as the increase is not greater ". . . than the maximum tax rate limit . . . afforded by the terms of any applicable statute."

6. In the event that a statute applicable to a certain fund made no provisions for increase by referendum or otherwise, the rate limit could be increased by referendum but not by more than 25 percent of ". . . such tax rate limit specified . . ."

7. *Any* increase approved by an ordinance or resolution of the town board and the electors at the April, 1952, town meeting which set a rate limit "greater than the maximum tax rate limit in effect as of the date of the adoption" [of the ordinance or resolution] could not take effect until a referendum on the subject was approved by the electors of the township.[15]

Statutory Rate Limits and the Hodge-Downing Amendment

Seemingly, then, the provisions of the Hodge-Downing Amendment ended the period of fixing rates according to a formula prepared by the state legislative body. The General Assembly, by not renewing the formula in 1953 and 1955, apparently reaffirmed this intent. Nevertheless, considerable difference of opinion exists over whether the period of rate fixing by the state has in fact ended and whether or not the Hodge-Downing Amendment is in reality unconstitutional.[16] In order to understand more clearly the basis for this division, it is necessary to divert our attention momentarily to an outline of the Illinois tax rate limit structure.

There are in Illinois, as has been indicated, a variety of tax rate limits which may exist for a particular governmental fund under certain circumstances. Generally, however, the tax rate limits fit into two categories: first, those limits for specifically named funds, which limits existed prior to the formula of the General Revenue Act and the Hodge-Downing Amendment and which can be called *statutory rate limits;* and second, those tax rate limits which were set by the formula provisions of the General Revenue Act and the Hodge-Downing Amendment and which can be called *formula rate limits.*[17]

The statutory rates, which were halved when the full assessment program was inaugurated, fall into two further classes. One class, typified by Fund X in the accompanying chart, has referenda provisions separate from the Hodge-Downing Amendment to the General Revenue Act which permit the *initial statutory rate limit* to be increased by referendum up to a *maximum statutory rate limit,* as indicated by arrow D.[18]

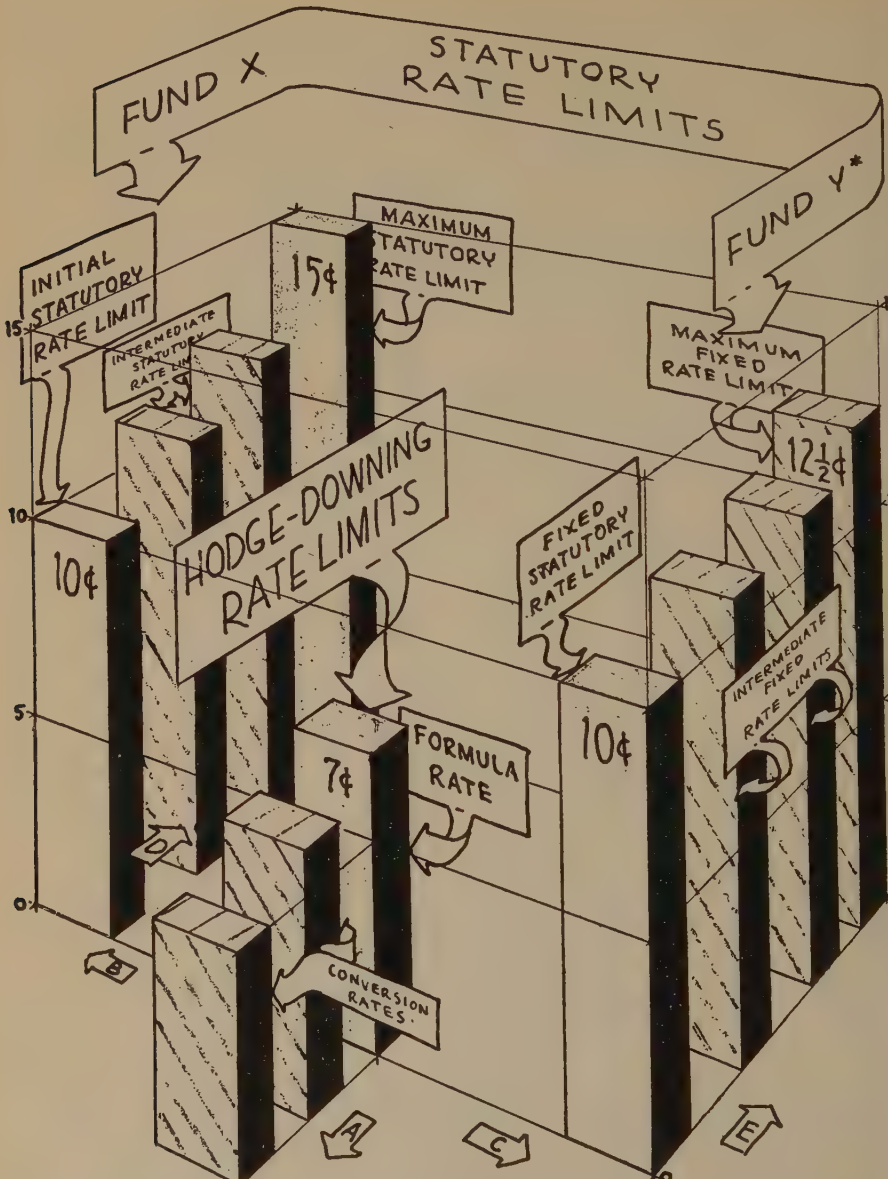
In the second instance, the statutory rate (designated Fund Y in the chart consists of a single specific rate limit for a named fund. That is to say, there are

[15] This provision does not apply to the town corporate rate since it is not limited.

[16] See Thomas Page and Norman G. P. Krausz, "Tax Rate Limits, H. B. 650," *Local Government Note No. 27* (Urbana: University of Illinois, Department of Agricultural Economics and the Institute of Government and Public Affairs, December 1, 1951).

[17] The italicized terminology for rate limits has been adopted solely for this exposition in an attempt to clarify the confusing and ambiguous terminology of the statutes.

[18] Grateful acknowledgment is made to Professor Tom Page of the Institute of Government and Public Affairs, University of Illinois, for his aid in preparing the chart.



* Although a fund falling under this classification has no referendum provisions for increasing the fixed statutory rate limit, the Hodge-Downing Amendment does prescribe that this rate may be increased up to 25 percent.

no statutory provisions separate from the Hodge-Downing Amendment for raising this *fixed statutory rate limit.* In such instances, however, the Hodge-Downing Amendment provided that this fixed limit could be increased by referendum to a *maximum fixed rate limit* which may be as much as 25 percent over the *fixed statutory rate limit,* as indicated by arrow E.

As indicated by the *formula rate* in the chart, the second major rate limit category consists of those rates set under the formula provisions of the Hodge-Downing Amendment. These rates are almost always lower than the *statutory rate limits.*[19] The *conversion rates,* which are lower than the *formula rate,* could have been set under the provisions by an ordinance or resolution passed by the governing body of the taxing unit not later than December 31, 1951.

The Interpretation of the Hodge-Downing Amendment

The controversy over the Hodge-Downing Amendment to the General Revenue Act in essence centered around how the various taxing units subject to the Revenue Act could move from the *formula rate* to the *initial* or *fixed statutory rate limit* (arrows B and C). To many the law seemed to be saying that in most instances such an increase in the tax rate limit could be accomplished only by referendum.[20]

Thus although certain provisions of the act as outlined earlier indicate that every corporate authority could establish, by resolution or ordinance passed before December 31, 1951, a maximum permissible tax rate, other provisions at the same time required that any increase beyond the *formula rate* be approved by referendum. The one exception to this rule appeared to be the instance where a city, village, or incorporated town could increase its corporate fund rate limit up to 10 percent beyond the *formula rate* limit by resolution or ordinance. Even in this case, however, a "backdoor referendum" was authorized.[21] In a sense a negative prerogative was given to local governmental units since by resolution or ordinance they could adopt the maximum *formula rate,* or a lower rate (arrow A), if they did not wish to use referenda provisions to increase their rate limits. Of course if no resolution or ordinance was adopted, the *formula rate* automatically went into effect after December 31, 1951. This *formula rate* could be changed but again a referendum was necessary.

Such an interpretation in essence implied that local taxing jurisdictions were in reality still tightly bound to *formula rate limits* established by a statute which is permanent in nature.[22] The fact that under this interpretation the act prescribed a referendum rather

[19] In certain instances where assessment before 1946 was close to full value (such as in Calhoun County) the provisions of the formula raised the *formula rate limit* above the *initial statutory rate limit.*

[20] Interview with E. L. Maynard, Property Tax Supervisor, Chicago, Department of Revenue, July, 1956.

[21] A "backdoor referendum" is called to challenge legislation already enacted as distinct from the commonly used referendum called to determine if legislation *may* be enacted.

[22] *Experts at TFI Clinic for County Officers,* Taxpayers Federation of Illinois, pp. 7 and 9.

than a resolution or ordinance to increase the *formula rate* to the *initial statutory rate* meant that local governments had obtained only a limited addition to their rate-fixing powers especially when it is recalled that the referenda provisions for increasing the *initial statutory rate limits* to the *maximum statutory rate limits* were already prescribed by statutes separate from the Hodge-Downing legislation.[23]

If this interpretation has been accurate, therefore, the provisions of the Hodge-Downing Amendment probably operate under doubtful constitutionality.[24] Under special question is the provision which forced local governments, if they did not adopt a rate limit by resolution or ordinance before December 31, 1951, to accept the *formula rate limit,* since the alternative was still the *formula rate limit* unless they decided to run the gantlet of a referendum.[25] This provision in practice, then, afforded local taxing units no real alternative. In these conditions of uncertainty some taxing units deliberately refrained from adopting a resolution or ordinance under the assumption that since this provision might be declared unconstitutional they would eventually be allowed to extend as much as the *initial statutory rate limit.* On the other hand adoption of the *formula rate* by resolution or ordinance would more than likely be considered permanent since it was a free choice of the local government involved.[26]

The Case of *People* v. *C. B. and Q. RR*

The restrictive interpretation given to the provisions of the Hodge-Downing Amendment has, however, been seriously challenged by a recent decision of the Illinois Supreme Court.[27]

In this case the Bureau County Board in November, 1951, using the resolution or ordinance provisions outlined earlier, adopted the *fixed statutory rate* limit of .0375 for the acquisition and maintenance of machinery under the county highway fund. This fund had no statutory referenda provisions for increasing the *fixed statutory rate limit* (compare Fund Y in chart). Later when a tax rate of .031 was extended by the county clerk, the railroad objected, claiming that under the formula the rate should have been .021. The court in deciding for the county stated that the rate originally fixed (.0375) was ". . . no greater than the tax-rate limit for such purposes fixed by the State Highway Act." The court further noted that the contention that the rate fixed should have been the *formula rate* was untenable ". . . since

[23] As already indicated, the Hodge-Downing Amendment did contain referenda provisions for increasing the *fixed statutory rate* by as much as 25 percent.

[24] It should be made clear, however, that the *Kremers* case may not necessarily be a precedent for ruling on the Hodge-Downing Amendment since in the case of *People Ex Rel. Carter* v. *Touchette* (5 2d Ill. 303, 1955) the Illinois Supreme Court decided that the *Kremers* case is ". . . authority only for what was actually there decided, namely that the library statute was invalid" (p. 307).

[25] See provision four on page 9.

[26] Interviews with E. L. Maynard, Property Tax Supervisor, Chicago, Department of Revenue, July, 1956, and John Bresee, State's Attorney, Champaign County, June, 1956.

[27] *People* v. *C. B. and Q. RR* (8 Ill. 2d. 382) March 22, 1956.

the stated purpose of section 162b [643b] is to provide for an orderly transfer from the maximum limits established by the General Assembly to the maximum limits established locally." The court concluded that if this logic were not valid ". . . [this section] would be meaningless."

Certain implications flow from this case. It seems relatively clear, for instance, that taxing units which desired to increase a *formula rate limit* to the *fixed statutory rate limit* could have authorized (and in this instance did authorize) this increase by a resolution or ordinance passed before December 31, 1951. As already pointed out, an increase by resolution or ordinance to the *fixed statutory rate* certainly was contrary to the prevailing opinion that such an increase could only be accomplished by referenda. This in turn could mean that any *formula rate* which existed for a fund with statutory provisions for increases by referenda (see Fund X in the chart) could also have been increased to the *initial statutory rate* without the need of a referendum. Under this interpretation the referenda provisions would go into effect only for the rates above the *fixed* and *initial statutory rate.*

Practically, this interpretation affects in varying ways the local units of government subject to the Hodge-Downing Amendment. In one sense it removed the constitutional cloud previously described. Under this interpretation local taxing units did have a positive possibility of increasing their *formula rate limits* by resolution or ordinance to the *initial* or *fixed statutory limit.* Those governments which authorized such an increase (even though at the time it was clearly thought to be contrary to the provisions of the Hodge-Downing Amendment) now may find that their action was proper and their rate limit legal. Those local governments which felt the Hodge-Downing Amendment prevented increasing the *formula rate* to the *initial* or *fixed statutory rate limit* except by referendum and which, therefore, felt obliged to adopt the *formula rate* by resolution or ordinance now in all likelihood find that the *formula rate* cannot be increased except by referendum. Theoretically at least, they had the alternative of increasing their rate limit but failed to do so. Similar logic would apply to those governments which deliberately adopted the *maximum formula rate limit* or a limit below that rate. Thus, in these instances permanent rates at variance with each other were *not* forced upon local governments of similar characteristics since they did have an opportunity to increase their rate to the *initial* or *fixed statutory rate limit.* This opportunity was certainly not clearly understood at the time even though the court has now declared that it existed.

In another sense, however, the constitutional cloud is reaffirmed by the *C. B. and Q.* case. The doubt centers around the provision in the Hodge-Downing Amendment which stated that if the taxing unit did not adopt the resolution or ordinance by December 31, 1951, it automatically was saddled with the *formula rate.* The effect of this provision before the recent case was, as has been pointed out, to offer local governments the alternative of the

formula rate by resolution or ordinance or without resolution or ordinance. If the interpretation of the *C. B. and Q.* case presented here stands, the court has implied that this alternative was not valid since by resolution or ordinance the local governmental unit should have been able to increase the *formula rate limit* to the *initial* or *fixed statutory rate limit.* Thus a *formula rate* forced upon a governmental unit as a result of its not taking advantage of the resolution or ordinance provisions before December 31, 1951, may be considered, under this interpretation, to be of doubtful validity.

Conclusions

The advent of the full value assessment program brought sharply into focus two basic viewpoints regarding property tax rate limits in Illinois. On one side there existed those groups who felt that giving local governments complete freedom in rate fixing, especially under the full assessment program, would result in inordinately high taxes for those who had to pay the property tax. Others, on the contrary, arguing that such a situation would not be likely to occur since the local government officials were elected by the very people they taxed, felt that after an adjustment period in which rates were fixed by a formula prescribed by the state, local governments should be allowed to levy any tax rate permitted under statutory prescriptions. The legislation and the court decisions from 1945 to 1956 are evidence of this continuing struggle.

The *Park Ridge* case of 1947 found the groups representing these two interpretations arrayed against each other. The issue: Should local governments be bound to a rate limit which restricted the amount of taxes they could receive or should they be granted a higher rate limit so that additional taxes could be raised? The court ruled in favor of the latter viewpoint. Those advocating more restrictive tax rate limits then successfully carried their struggle to the General Assembly since H. B. 513 of 1947 again restored restrictive tax rate limits to local governments. But the Illinois Supreme Court interceded again in 1950 by implying in the *Kremers* case that any attempt to make these nonuniform temporary rates permanent would be looked upon with disfavor. Once more, the General Assembly was forced to adjust the rate limit legislation to meet the objection of the court by passing the Hodge-Downing Amendment. The provisions of this bill terminated the formula and seemingly returned the prerogatives of rate fixing to local governments. But under the restrictive interpretation which in most instances was adopted by local taxing units, formula rates were in effect perpetuated. The dispute was again joined: Was the restrictive interpretation correct? Did not such interpretation raise constitutional doubts regarding some of the provisions of the act in view of the *Kremers* case? Or on the other hand, was a more liberal interpretation justified, one which would in fact return many of the powers of rate fixing to local taxing jurisdictions? As in previous instances, the Illinois Supreme Court rendered a decision which, at least to those who wish to see fewer restrictions upon such rate-

fixing powers, implied that a liberal interpretation of the Hodge-Downing provisions should prevail. As a result some of the rates established under the law are now under serious question.

It is apparent at this point that the issue of a restrictive interpretation of tax rate limits versus the liberal interpretation has not been resolved. Until the Illinois Supreme Court rules directly on the various points raised by the opposing interpretations or until legislative action clarifies the tax rate limitation laws, local governmental units and the average citizen will be forced to live in uncertainty regarding what the legal tax rate limits actually are in Illinois.

The Right-to-Work Debate

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A DISCUSSION of the wisdom and justice of enacting right-to-work laws in the states usually becomes an expression of attitudes toward strong unionism, effective collective bargaining, and the extent of individual freedom that is compatible with the welfare of society. Discussion of the laws brings out strong opinions. There is little gray in the pictures painted by most discussants; the view is very white or very black. Organized labor and its sympathizers view the enactment of such measures with much alarm. Many persons sympathetic toward the point of view of small business or agriculture hope to see more states enact right-to-work legislation.

At the close of 1956, 18 states had statutes or constitutional amendments embodying the right-to-work philosophy. These states included all the southern states except Kentucky and Louisiana[1] plus the Dakotas, Nebraska, Iowa, Arizona, Nevada, and Utah. In general, all these states were industrialized to a relatively small extent. The state measures made it unlawful to require any person to join a union or refrain from joining a union in order to secure or keep a job.

Although one state had enacted a law embodying the right-to-work philosophy prior to enactment of the Taft-Hartley Act, the right-to-work movement was encouraged by that Federal legislation. Section 14 (b) provides that "Nothing in this Act shall be construed as authorizing the execution or application of agreements requiring membership in a labor organization as a condition of employment in any State or Territory in which such execution or application is prohibited by State or Territorial law." State discretion is allowed to supersede Federal policy only if the state law is more restrictive of "union security" clauses. A state may not, for example, elect to allow the closed shop and expect its legislation to take precedence over Federal policy. The Federal law was not enacted in a spirit of recognizing states rights to legislate in the labor relations field in any manner they chose. States rights were recognized only if the states elected to legislate in a manner acceptable to Congress.

Case for Right-to-Work Laws

Proponents of right-to-work measures relate their support to individual freedom. Donald Richberg refers to "the new slavery" in discussing union security provisions such as the union shop.[2] He also refers to the union shop clause as a new kind of "yellow dog contract." The National Right-to-Work

[1] The Louisiana law was repealed in the summer of 1956 and reapplied to agricultural workers. In the general election, November 6, 1956, the voters disapproved a proposed right-to-work law in the State of Washington.

[2] *Human Events,* Vol. 12, No. 27, July 2, 1955, Article Section, Human Events, Inc., Washington, D. C.

Committee makes a similar inference in entitling one of its pamphlets "Forced Union Membership Steals *Your* Freedom."

The Chamber of Commerce of the United States views the issue in much the same light. To the Chamber "The issue is only this: Should any American be forced, under penalty of loss of livelihood, to join and support a particular private organization . . . a union . . .?"[3] The term "compulsory unionism" is used time and again in the publication cited. Essentially the argument centers on the proposition that if persons may choose whether to join a union, the union will be run much more effectively and with fewer abuses; if the union must "sell itself" it will be a better union.

Typically this general "individual freedom" argument is bolstered by a number of points, which in essence spell out the philosophy of individualism. The Chamber of Commerce, in its publications, urges that compulsory union membership amounts to private taxation. Further it is implied that most workers do not want unions to negotiate security clauses.

Statements issued by the National Right-to-Work Committee present the same viewpoint, but offer other arguments as well. They urge that the rights and wishes of minorities should be protected. It is said that unions want power but do not wish to accept responsibility. Also it is urged that nonmembers of unions are not free riders getting the benefits of union bargaining without helping to pay the costs.

Certain activities or abuses of unions are also cited as reasons for enactment of right-to-work laws. A business executive, for example, states that matters such as the following may cause a person to wish to remain a nonmember of any union: there are Communist and socialist (not defined) unions; a prospective member may object to the political activity of a union, to sit-down strikes, mass picketing, or violence on the picket line; racketeering or the preaching of class warfare may be the deterrent.[4] This executive might have added that discriminatory policies on admission to membership may have kept some persons out of unions as has the belief of some that unions are run so highhandedly that the individual member will be only a pawn.

Support of right-to-work laws is not limited to groups such as those just referred to. Professors, lawyers, and other professional workers interested in labor relations and labor law have joined in the controversy. One writer has expressed the opinion that right-to-work laws are "the number one labor-political issue today."[5] If this were true in 1955, probably it is equally true in 1956. In the spring of 1956 the National Right-to-Work Committee announced its intention to make an effort

[3] *The Case for Voluntary Unionism* (Washington: Chamber of Commerce of the United States), p. 3.

[4] Taken from a speech by J. C. Gibson prepared for and delivered in summary form before the annual spring meeting of the Industrial Relations Research Association, Milwaukee, May 4, 1956.

[5] E. F. Cheit, "Union Security and the Right to Work," *Labor Law Journal*, Vol. 6, No. 6 (June, 1955), p. 357.

in 1956 and 1957 to secure extension of right-to-work measures to 15 states other than those now having such measures. In addition the measures now standing will be up for consideration in many of the states. Thus, right-to-work legislation may be an issue in well over half the states in the coming months.

Opposition to Right-to-Work Legislation

Whether the opponents of right-to-work laws are unionists or other persons with similar convictions, their attack on the laws is likely to be much the same. These arguments were summarized in the first issue of *Labor's Economic Review* published by the newly merged AFL-CIO.[6] That organization makes the following points: (1) Workers vote for union security clauses. To bolster their contention they cite the results of union security elections under the Taft-Hartley Act under which about 97 percent of the elections resulted in a vote favorable to union security. (2) The right-to-work issue is a false one — the state laws ensure no one a clear right to work. (3) Unions protect workers' rights. In general this is the argument that workers need to join unions because of the weak bargaining power of individuals. (4) The union designated by a majority of employees is the exclusive bargaining agent for all workers and has an obligation to represent all workers. (5) Since a majority of all workers in organized plants wish union representation, the majority should rule. (6) The nonmember of a union who enjoys benefits as a result of union negotiations or other actions is similar to a tax dodger — he is a "free rider." (7) Union shops are widespread in the nation and have developed over a period of many years in answer to a need.[7]

The issue between the proponents and opponents of right-to-work measures reduces itself to whether a person favors strong unions and collective bargaining, or whether more faith is placed in individual freedom to act with little regard for the attitudes of the group. There is little ground for compromise.

Foundation of Right-to-Work Legislation

The right-to-work issue is not new except in name; it is the open-shop campaign under another title. Ever since unions began to grow in this country, there has been a running controversy between those who wish to build the union movement and those who wish no unions or weak and subservient organizations. At one stage of our history the struggle centered around the application of the conspiracy doctrine to organized labor; the use of injunctions in labor disputes has been a struggle of varying degrees of intensity for more than a half-century. The "American Way" slogan of the 1920's was another facet of the same struggle, as was the fostering of company unions. All of these more "civilized" means of opposition to the growth in the size and strength of unions were pushed into the

[6] *Labor's Economic Review,* Vol. 1, No. 1 (January, 1956), pp. 1-8.

[7] These and other points are developed in more detail in *The Case Against Right to Work Laws* (Washington: Congress of Industrial Organization, 1954).

background from time to time by the violence that has marred the attempts to unionize various establishments, industries, or areas.

The issue (of strong unions) is not a surprising one in view of the marked difference in the attitude and philosophy of workers on the one hand and of employers, professional personnel, and farmers on the other hand. The average worker searches for security. In the opinion of the writer, employers and professional people fail to understand that workers, whether consciously or not, want to feel secure in their jobs. They and their union officials take the same position with regard to their organization.

A businessman, farmer, or professional man finds it difficult to understand the desire for security of working people. The former are individualists. The farmer gambles his knowledge, experience, and effort in an attempt to conduct his enterprise profitably. Although he may be a member of a grange, farm bureau, cooperative, or other organization, he is, to a large extent, on his own. Business owners and managers do much the same, although they may be more inclined toward group effort through associations or other organizations. The average doctor, lawyer, or professor gives many years to formal schooling. He hopes, by increasing his knowledge and ability, to get ahead in life — largely through his own efforts. Persons of the persuasion of the latter group hope that government will follow policies which will serve to underwrite the opportunity of individuals to exercise initiative. Persons of the conviction of the average worker will look to the government to ensure security — for himself and the institutions he values.

Probably neither group understands clearly the point of view of the other. With regard to right-to-work laws, as well as other issues, the frictions that develop are intensified and complicated by lack of a common foundation of value judgments on which to base discussion.

An examination shows that right-to-work laws have been enacted chiefly in states with relatively little industrialization. Probably this is a result, at least in part, of the greater prevalence of the individualistic, conservative philosophy of the farmer and small businessman. In addition some public officials seem to hope that industry may be attracted to the state by the outlawing of the union or closed shop.

There is something of a paradox in the enactment of anti-union-security measures in the states that have taken this action. Union organization and subsequent solidification of its position are likely to precede the union or closed shop. Since there is no prohibition of union organizational work as such, but only of subsequent developments through collective bargaining, any hope of preventing the entry of unions into the states with such laws seems likely to be at best only partially realized.

Evaluation of the Arguments

I.

Even though the proponents of either side of the controversy may find it difficult to understand the point of view

of the other, a number of the supporting ideas developed by one or the other merit examination. Perhaps it may be well to examine first the name commonly given to the measures under discussion. "Right-to-work" is not a reasonably descriptive term to apply to the statutes; the phrase is a misleading euphemism. It has been said that the right to work is honeycombed with conditions. None of us has a right to work unless he can satisfy certain conditions — perhaps educational or skill requirements, possibly specifications as to age or sex, or many other such standards. There is no apparent reason why employer or government should be the only ones that can establish requirements to be met. If a majority of the workers with whom prospective employees will come in contact wish to set up a condition (not arbitrarily and unjustly violative of the rights of would-be workers), it would seem to be defensible. Certainly employees have a legitimate interest in the conditions under which work is performed.

To be meaningful, a right imposes a duty on someone. If there is really a right to work, it is the duty of some person or group (within the political jurisdiction that has stated legislatively that there is such a right) to offer an opportunity to work. Yet the proponents of right-to-work laws would be most reluctant to impose on any employer the duty to offer jobs unless that employer wished to do so. The only duty realistically imposed by right-to-work laws is the duty to allow workers who can find jobs to work even if they refuse to join the union. At best they remove only one condition of continued employment that might be an issue with a minority of workers.

Contrary to the urging of proponents of right-to-work measures, it is doubtful if protection of freedom of the individual is in truth a compelling reason for the enactments. Most of the states now having espoused the right-to-work principle are in the South. The continuation and intensification of opposition to desegregation raises serious doubt about the degree of genuine interest in the many aspects of individual freedom. Ensuring individual freedom is only an excuse or smoke screen for opposition to effective unionism.

There is still another reason to look with doubt on the assertion that protection of individual freedom is basic to the enactment of such laws. Unions are a type of institution that is weakened markedly by the failure of sizable groups to join the organization. Refusal of even a minority to join may well make the union relatively ineffective as a means of collective bargaining. If most of the employees want an effective and stalwart union to represent them, the abstention of the non-joiners may thwart the desires of the individuals who constitute a majority. In a society as complex and interdependent as that of the United States today, no person can enjoy complete freedom to act in any way that he chooses. The freedom of individuals must be limited at the point where it begins to infringe seriously on the freedom of others.

The United States Chamber of Commerce, as was noted earlier, has raised the question of whether "any Ameri-

can" should be forced "to join and support a particular *private* organization." Here is a major weakness in the case of the pro-right-to-work group; a union is not, by any stretch of the imagination, a private organization in the sense that a lodge or club may be. The union is an institution clothed with a public interest, and recognized and sanctioned by law. Congress and the Supreme Court have recognized that unions occupy a quasi-legislative position in our society. The functions they perform (which by and large are important and worthwhile services to society) develop within a framework of government policy and within a certain permissible sphere of activity.

In the words of Mr. Justice Frankfurter, "A labor agreement is a code for the government of an industrial enterprise and like all government, ultimately depends for its effectiveness on the quality of enforcement of its code."[8] In another instance the Supreme Court said, "Congress has seen fit to clothe the bargaining representative with powers comparable to those possessed by a legislative body both to create and restrict the rights of those whom it represents."[9]

Certainly the practices found in labor-management relations today support the idea of the Court that unions are quasi-public institutions. The actions of unions in developing agreements amount to legislating a sort of "industrial common law" to guide relations between the negotiators. The day-to-day applications and interpretations of the agreement, and the use of the grievance procedure amounts to administrative and judicial processes important to hundreds of thousands of workers. Certainly economic institutions as significant as present-day trade unions cannot properly be classed as purely private bodies.

It is to be expected that not all members will be satisfied with the political policies and programs of their union.[10] No group as diverse as the membership of a union will have a unanimous view on any issue. However, a relatively small proportion of union funds are expended for political action and most union members probably agree with the political action of their union.

Abuses such as discriminatory or restrictive membership policies cannot be passed off lightly. However, racially based admission policies were held by Peterson[11] a decade ago to be relatively minor in the context of the total union movement, although troublesome in railway transportation and building trades unions. Progress, through legislation and by union policy, has been made since that time. Many unions have done much to combat or stamp out racial intolerance. Here again, viewed in perspective, the problem is not major.

The general evaluation drawn as to

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[8] *Aeronautical Industrial District Lodge 727* v. *Campbell et al.*, 337 U. S. 521 (1949).

[9] *Steele* v. *Louisville and Nashville Railroad Company et al.*, 323 U. S. 192 (1944).

[10] The fear that sizable numbers of workers may be forced to join Communist unions is not well founded. The efforts of the Federal government and the great majority of labor leaders have reduced the threat of Communist unionism to small proportions.

[11] Florence Peterson, *American Labor Unions* (New York: Harper and Brothers, 1945), pp. 86-90.

the commonly cited justifications for right-to-work laws is that they do not impress. They are convenient, pleasant-sounding excuses for taking a course previously chosen.

II.

If the contentions of proponents of right-to-work measures are unconvincing, what of the position of opponents? In the writer's judgment their case is the stronger.

Workers themselves generally favor union security clauses. The economic status and prestige of workers is enhanced by the union movement; jobs are more secure, arbitrary actions by management less common, and the general respect shown to workers greater with the advent of strong unions. To paraphrase the comments of one union member to the writer, "Even if unions didn't do anything to affect wages, which I do not believe is true, we would get our money back from our dues in the way in which the union serves to control the arbitrary action of the foreman."

While union action is needed to ensure that matters such as wage standards are reasonably applied to all, union activities may be even more desirable in less clearly recognizable areas. It is important that persons be dealt with justly with regard to promotions, lay-offs, recalls, disciplinary action, and other issues that may be very important to the worker and his relationship to the job. Management actions in these and related areas are likely to be less arbitrary or capricious where there is a union representing all workers than will be the case when there is no union.

Unions are responsible for representing all persons within a certain bargaining unit. Sections 8-a-3 and 8-b-2 of the Taft-Hartley Act make it clear that workers are to be treated similarly whether members of the union or not. The Supreme Court has spelled out the responsibility of a union to represent all workers in a bargaining unit in strong and positive language. "So long as a labor union assumes to act as the statutory representative of a craft, it cannot rightly refuse to perform the duty, which is inescapable from the power of representation conferred upon it, to represent the entire membership of the craft."[12]

Thus unions have had thrust upon them a responsibility to serve all who are members or work under conditions negotiated by the union. Since this is their responsibility, all workers, it may be urged, should help to support the organization chosen to represent the workers. To urge that not all are morally obligated to support the bargaining instrument is to support the free loader — the person unwilling to assume his responsibilities to the society in which he lives and from which he benefits. Mr. Justice Brandeis commented on this matter a generation ago, saying, "all rights are derived from the purposes of the society in which they exist; above all rights rises duty to the community."[13]

There is at least one more reason for challenging the desirability of laws restricting the signing of union security

[12] *Steele* v. *Louisville and Nashville Railroad Company, op. cit.*

[13] Dissenting in *Duplex Printing Press Co.* v. *Deering*, 254 U. S. 443 (1921).

clauses. Some sort of union security clause was found in 1954 in roughly four out of every five agreements, according to a report of the Bureau of Labor Statistics.[14] About two-thirds of the agreements provided for the union shop. The results of union shop elections under the Taft-Hartley law suggest strongly that union security clauses are acceptable to, or desired by, most workers. Even many employers or their representatives accept or support the idea of union security provisions. Further, the Congress has accepted, although certainly not encouraged, the union shop, or other form of union security short of the closed shop. Under the circumstances, the states should not be in a position to disallow completely all forms of union security. And the wisdom of interfering with a custom so well established as the union shop is open to still further question.

Effects of Right-to-Work Laws

The results of right-to-work legislation cannot readily be determined. It is never possible to know what would have happened if another course of action had been followed. We do not know what the situation would have been if these laws had not been enacted. Mindful of this fact, Professor Frederic Meyers has made some tentative estimates of certain effects of the Texas law. He is of the opinion that the law has had little effect on the rate at which employees initially are organized except possibly in construction, local trucking, and printing. He believes that unions have tried to solidify their position with members by acceding readily (too readily in some cases) to member demands for processing grievances, which are sometimes poorly founded.[15]

Professor John Kuhlman reports his views of certain specific effects of the Virginia law. He believes that, *de facto*, the law has not eliminated the union shop nor has it reduced the number of labor-management disputes. An examination of data relative to labor disputes in Nebraska under such legislation leads Professor Kuhlman to the same conclusion — no perceivable diminution in disputes.[16]

One may speculate that the laws under examination have had little effect on the rate of growth in union membership. A study made by the National Bureau of Economic Research makes estimates of growth in numbers of members of unions from 1939 to 1953.[17] States were placed in three groups — those in which membership had grown less than 150 percent; those in which the increase was from 150 to 225 percent; and those in which the increase was estimated to be in excess of 225 percent.

This study reports that only three of the states enacting right-to-work laws during the period had increases of less than 150 percent; five experienced

[14] *Monthly Labor Review*, Vol. 78, No. 6 (June, 1955), p. 649.

[15] Frederic Meyers, "Effects of 'Right-to-Work' Laws: A Study of the Texas Act," *Industrial and Labor Relations Review*, Vol. 9, No. 1 (October, 1955), p. 84.

[16] John Kuhlman, "Right-to-Work Laws: The Virginia Experience," *Labor Law Journal*, Vol. 6, No. 7 (July, 1955), p. 494.

[17] Taken from a preliminary report on the study appearing in *Business Week*, June 19, 1956, p. 169.

growth in excess of 225 percent. Of the 30 states not enacting right-to-work laws, 10 experienced union growth of less than 150 percent whereas only seven had increases in excess of 225 percent.

These bits of data suggest that right-to-work laws have had relatively little effect in keeping down union growth or promoting labor peace. Probably this is to be expected. Technically, these laws affect that which can be done *after* organization rather than the rate of organization. In addition to these estimates of the effect of these laws in certain geographic areas or in certain relationships, a few estimates of the general effect of the laws may be of interest.

Secretary of Labor Mitchell has said of these laws, ". . . they do more harm than good. In the first place they do not create any jobs at all. In the second place they result in undesirable and unnecessary limitations upon freedom of working men and women and their employers, to bargain collectively and agree upon conditions of work. Thirdly, they restrict union security and thereby undermine the basic strength of labor organization."[18]

An examination of the Virginia law produced the following evaluation, ". . . it is impossible to conclude that the passage of the right-to-work law has made a positive contribution to labor-management relations. There is no evidence to indicate that it has reduced the number of strikes . . . There is . . . considerable evidence that the law is unenforceable and that a considerable number of unions and employers practice some sort of union security. It has, however, served as a device which can be used to harass unions."[19]

Additional citations similar in tone could be quoted. Of course, an equal number probably could be offered which point to the conclusion that right-to-work measures are desirable. As said at the beginning of this discussion, the position taken with regard to these laws rests largely on whether the person favors strong unions or weak and docile (or nonexistent) ones. The writer is of the opinion that strong, responsible unions serve the best interests of the nation. Despite modifications brought by the Taft-Hartley Law, congressional sanction of independent, non-company-dominated unions still stands; state laws should not be allowed to undermine Federal policy, indeed to follow a policy destructive of stated Federal policy.

Summary

In sum, this discussion reaches the following conclusions: (1) The name "right-to-work laws" is misleading; the laws impose on no person or institution the duty of making jobs available to anyone. (2) The Taft-Hartley provision that gave rise to most of the state laws does not represent a true extension of states rights; states can only enact measures more restrictive of union security and may not enact less restrictive measures and expect them to override the Federal measure.

[18] U. S. Department of Labor Press Release, Monday, March 28, 1955.

[19] Kuhlman, *loc. cit.*

(3) There is not a genuine solicitude for individual freedom prevalent in most of the states with right-to-work measures. Various restrictions on the liberties of many citizens are sanctioned in these states. (4) Right-to-work measures are but a new method of attack in the century-and-a-half-long fight to prevent the growth (or weaken the strength) of organized labor in the United States. (5) Labor unions, far from perfect, have grown in the country to meet a felt need of workers for group actions to enhance their bargaining position. Although spotty and intermittent, the long-run trend is clearly toward stronger and more responsible unions.

Some Aspects of Industrial Protectionism in Latin America

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FEW PEOPLE would deny that the Latin American industrialization drive is an accomplished fact. Its degree of success is not so clear and may be open to debate. Consequently, the discussion here is less an attempt to justify the policies of the industrialization drive in its present stage than one to explain the origin and early logic of those policies, many of which are carried on today.

It would also be relevant to keep in mind that in most Latin American countries socialism has never been endorsed in any doctrinaire sense. On the contrary, most of the wealth in Latin America is still privately owned and managed. This does not preclude, however, evolvement under the aegis of government protection and encouragement of large private sectors of the Latin American economies. Subsequent analysis, therefore, will be mainly concerned with government policies with respect to private enterprise, and with the goal to industrialize which is a crystallization of early protectionist policies.

Since most Latin American countries have followed almost the same pattern and principles, adjusting specific measures to their particular environments, one country will be singled out whenever necessary to illustrate the development of industrial protectionism, sometimes referred to as the "Latin American industrialization drive."

Early Protectionism

Most Latin American countries were ardent followers of the idea of economic liberalism during much of the nineteenth century. This was a natural reaction to the mercantilistic policies followed by Spain during colonial days. With the spread of the industrial revolution in the world and with the increasing dependence of raw material supplying countries on world markets, however, a definite reaction to economic liberalism was clearly discernible in some Latin American countries during the latter part of the nineteenth century. These early reactions eventually set the pattern for the remaining republics to change their economic policies during the depression years of the 1930's. Some writers refer to this latter period as the origin of "the economic policy revolution in Latin America."[1]

What many of the Latin American republics were forced to do in the 1930's, Uruguay for example, being in the vanguard of the economic policy revolution in Latin America, started to do in a planned manner as early as 1875. The passage of the Uruguayan Customs Law of 1875 represented an

[1] Eastin Nelson, "A Revolution in Economic Policy: An Hypothesis of Social Dynamics in Latin America," *Southwestern Social Science Quarterly* (Austin: University of Texas Press), Vol. 33, No. 12 (December, 1953), pp. 3-16.

almost complete reversal of the liberal customs law of 1861 — which was only a mild revenue tariff — and marked the beginning of the end of classical economic liberalism in that country. The main characteristic of this new tariff code, as in many consecutive codes later adopted in other sister republics, was the introduction of new tariffs for products that could be produced at home. On the other hand, tariffs were reduced or abolished for all materials to be bought abroad for domestic processing.

Effect of the New Tariff Laws

The significance of the new law becomes evident for Uruguay, and for the other republics upon their later introduction of similar laws, when it is recalled that Uruguay, for instance, though an agricultural country in those days, had to import such products as flour, spaghetti, crackers, shoes, and alcoholic drinks. As a matter of fact, almost nothing except meat and raw agro-pastoral exports were produced in the country.

The effect of the new tariff legislation was impressive on two counts:

(1) Tariff revenues, then the main source of government revenue dropped 50 percent, and

(2) Imports of goods such as candy, linseed oil, cheese, peas, matches, tanned leather, alpargatas (shoes), furniture, all sorts of woolen blankets, and other goods, dropped considerably as their production was initiated by local producers.

Criticism of the new measures ran high, of course, as it always does when new legislation is passed and established interests are hurt, in this case an established group of importers. But the government did not surrender its protectionism, because the new policy afforded a degree of welcome relief in the form of employment for the rapidly increasing urban population. And though customs revenues declined, eventually other taxes, generally indirect ones, were devised to make up the losses. Moreover, increased home production of formerly imported goods provided new domestic sources of revenue. In addition, another advantage became evident, namely that the costs of some articles declined after their manufacture in Uruguay was established. For example, leather that sold for eleven pesos before 1875 went down to half that price after it began to be produced and tanned in the country.[2]

In Uruguay nobody seriously criticized the infant industry argument, at least not in connection with the products mentioned, which were thenceforth to be processed at home. There has been criticism, however, of the fact that protectionism has never been considered a temporary measure, but was designed from the beginning to be a permanent policy.

Latin American governments believe that there is a difference between the infant industry argument with respect to one industry in a relatively advanced country and the same argument with respect to an entire nation having no industry at all, but trying to change from an agrarian nation to an industrial one. As early as 1888, the

[2] Simon G. Hanson, *Utopia in Uruguay* (New York: Oxford University Press, 1938), p. 11.

following report was presented to the Uruguayan House of Representatives by one of its outstanding economists:

But, what can we expect as a commercial nation, when a great part of our business elements are not native, and commercial capital is always uncertain?

Commercial capital goes as it comes, as a result of any chance fluctuation, never takes root, is always moving, capricious, tomorrow it will turn its back on what it eagerly seeks today.

We have no merchant marine, which is an essential base for our national economy, and as long as we remain producers of raw materials which we must exchange for manufactured goods that are brought to us, we will remain a species of foreign colony.

The making of a nation and of economic independence depends on domestic industry, that is to say, on the proportional development of productive forces for the employment of the national labor force, and on permanent capital investments.[3]

Because of the acceptance of the hypothesis that there exists a difference between an infant industry and a country yet to be industrialized in its entirety, protectionism became in Uruguay, as it did later in most other Latin American countries, a permanent and *de facto* economic developmental policy. Once the manufacture of certain products was initiated at home, manufacturers could count on indefinite protection against foreign competition. As a matter of fact, manufacturing would simply not be started without such a guarantee. The result of such a policy, of course, is oftentimes an uneconomical allocation of resources because of the neglect of the law of comparative advantages. But Latin American governments often considered it more important to be able to secure work for their unemployed than to enjoy the indirect benefits of comparative advantage. Most Latin American countries have been very successful in absorbing unemployment which generally was, and still is, made up of underemployed people on the farms but which also results from a rapidly increasing population.

On the whole, though, and in spite of protectionist policies, Latin American governments seem to have expected that the prices of home produced goods would not be too far out of line with foreign competition, that is, with the prices of former imports. This was indicated by the fact that wherever protection was abused and private monopolies appeared, as in the Uruguayan production of alcohol, for example, the government eventually took the industry over or declared it a state monopoly. The many state monopolies that were later established in most Latin American countries were, therefore, only logical extrapolations of the earlier policies of industrial protection.

Here is probably found a considerable difference between Latin American public policy and the way similar problems are handled in the United States. Many non-Latin American economists erroneously think that public ownership of utilities in Latin America is the result of a strong belief in socialism. This, of course, is not the case. Latin American governments in principle and in practice do not permit the existence of private monopolies. If as a result of protectionist policy a monopoly develops, it is likely to be regulated or

[3] *Revista de la Union Industrial* (Montevideo: August, 1952), Ano 56, No. 87, p. 89.

taken over by the government in order to make the monopoly benefits available to the public in general. In the United States similar problems are sometimes handled through antitrust legislation which often leaves doubt as to its effectiveness in connection with the actual benefits the public derives or is supposed to derive.

Further Expansion of Protective Legislation

After the Uruguayan protective tariff legislation of 1875, a struggle started between free traders and protectionists and various laws were passed. But the protectionists won finally in the famous law of October 12, 1912, which contained the following main provisions:

(1) Exemption from duties of raw materials used in home industries.

(2) Reduction of duties by 5 to 25 percent for some finished products bought abroad but used by the Uruguayan industries.

(3) Ten-year exemption from duties for machines, apparatus, and spare parts for the installation of new industries or used for the replacement of old ones and their renovation.

(4) Tax exemption for 10 years for installations in industries not yet represented in the country, or for new installations if existing ones in the industry have a 10-year exemption.

(5) Drawback concessions for imports processed in the country and then exported.[4]

Though it appears that the provisions of the 1912 law made for freer rather than for more restricted trade, this is of course not the case. The new law gave tariff and tax advantages only to national industries, and, therefore, put foreign suppliers in a less competitive position since tariffs for their products were actually raised.

The 1912 law was followed by further decrees in 1931 and was amplified in 1935. It is a remarkable coincidence that in 1912 and in 1935 industrial development was accelerated by these laws a few years before a major war — just when the country would need the newly established industries most.

In 1940, the whole tariff structure was revised without changing its protective character, but taking into account the new difficulties that arose because of the war-induced shortages of raw materials and shipping space. The protective tariff policies of the government were reinforced by its system of foreign exchange controls which had been introduced in 1931 when some such action was indicated by the drop in agricultural prices. Since demand for agricultural exports was relatively fixed, a drop in prices resulting from the general world depression of the 1930's meant receipt of less total revenue for agricultural exports. Import demand on the other hand was more elastic. Import outlays, therefore, did not decrease to the same extent as the total revenue from agricultural exports. The result was the creation of an import balance. Consequently, an

[4] Consejo Interamericano de Comercio y Produccion, *Encuesta Continental Sobre Fomento y Coordinacion de Industrias — Repuesta Referente a la Republica Oriental del Uruguay* (Montevideo: 1947), pp. 106-107.

exchange control program was designed to ration foreign exchange and to protect the peso. This system has been better administered with the passage of time and is today one of the strongest developmental policy weapons of the Uruguayan government and of some of the other Latin American republics.

Many Latin American nations have followed the Uruguayan example, going through much the same sequence of policy decision changes, but with a lag of many years. Mexico, for example, enacted provisions similar to the Uruguayan law of 1912 as late as April 21, 1941; such an advanced country as Argentina followed a definite policy of nineteenth century economic liberalism until the end of 1930.

Postwar Policies

Today the protective policies of the Latin American governments are stronger than ever, since two major wars have taught the republics what it means to be exclusively dependent on free trade. Ever since the outbreak of the Second World War, a policy of preferential treatment for the importation of machinery has been adopted, and sometimes outright embargoes have been imposed on so-called luxuries. Furthermore, subsidies and preferential treatment have been given to exports of semimanufactured goods, as for example in Uruguay to combed and washed wools, powdered milk, flour instead of wheat, and to linseed oil, in order to get away from the dependence on only a few export goods and to increase and diversify the country's industrialization.

Any reasonably feasible aspect of domestic production is now encouraged. In many Latin American countries it is argued that agriculture is already producing all it can, and that because of increased mechanization, agriculture needs fewer and fewer people every year. Therefore, additional output of industry, employing labor not needed in agriculture, will be a net addition to national product.

Expansion of industrial output will take care of disguised unemployment on the farms and of unemployment in the cities and urban centers. In the more advanced republics of Latin America, rapid population increase and mechanization of farms creates a permanent exodus of unemployed labor to the cities. Only industry can absorb these people and simultaneously add to the national product.

Latin America has had the fastest growing population in the world for the past three decades. Nevertheless, no decrease in per capita food production has been noticeable as a result of the area's protectionist policies, nor have total exports declined. The only result of the new policies has been a structural change in imports. Machinery and raw material imports now take first place, whereas finished consumer items and processed food imports played the most important role in the past. In Uruguay it is argued, for example, that if the critics of its protectionist policies had their way, Uruguay would still be importing corned beef and canned peas because they could be packed and processed more cheaply in England or the United States before local processing began.

The countries that have industrial-

ized even without extensive domestic raw material bases, such as Switzerland, Belgium, and Holland, are prosperous, it is contended, whereas the countries still dependent on a few main exports such as tin, petroleum, rubber, or one or a few agricultural products, are backward. Denmark, for example, has no iron and no coal but nevertheless produces oil tankers in competition with Great Britain and Germany. Finally, it is said in the case of Uruguay that if it does not industrialize, it will soon lose its economic independence to Argentina and Brazil, who are making significant strides in that direction. Of course, this argument applies to all of Latin America when its economic independence is reviewed in the light of such industrialized world powers as the United States and Great Britain. It is probably true that comparative advantages would be lost if each republic were to industrialize without regard to the size of its market and the needs of neighboring republics. But apparently economic and political independence can only be bought at a price.

Measures of Success

Latin America is currently determined to proceed with its industrialization drive at almost any cost. Whether it has lost by pursuing this policy, which has been followed energetically since 1936, is not completely clear. Nevertheless, the fact remains that Latin America more than doubled its industrial output between 1936 and 1956, while agricultural output also increased perceptibly in real terms and volume. The following three tables give an indication as to the success of Latin America's industrialization drive and general economic development.

Table 1. Annual Rate of Per Capita Growth, 1945-1955[a]

Measure of growth	Percent
Gross product[a]	2.4
Gross income[b]	3.4
Available goods and services	3.6
Consumption	3.1
Total investment	6.3
Investment in fixed capital	5.0

[a] *Gross product* means the gross domestic product at market prices, that is, the market value of the product attributable to the factors of production located within the country before allowance for depreciation.

[b] *Gross income* designates the sum of gross national product in prices of a base year (1950) and the calculated gain (or loss) resulting from changes in the terms at which exports are exchanged against imports relative to the prices that prevailed in the base year.

For a more detailed explanation of gross product and gross income, see *Economic Survey of Latin America, 1955,* p. 20.

Source: United Nations, Department of Economic Affairs, Economic Commission for Latin America, *Economic Survey of Latin America, 1955* (New York: Columbia University Press, 1956), p. 3.

As can be seen from Table 1, the rate of progress compares favorably with the historic 2 percent rate of improvement in living standards in the United States.[5] Table 2 gives a clear indication of the accelerated rate of growth of the manufacturing and tertiary sectors for the 1945-55 period.

Table 3 presents detailed data on the development of industrial production in Uruguay, which is thought of as being predominantly a producer of livestock and agricultural raw materials. Since 1936 industrial output in

[5] Chase National Bank, *Latin American Business Highlights,* December, 1954, p. 2.

Uruguay has doubled. Agricultural expansion, on the other hand, has just kept pace with a population increase of 13 percent for the entire period 1936-51. The result has been a changing pattern of production. Manufacturing output today contributes more to Uruguay's gross national product than agriculture and livestock raising do. The same pattern of development can be traced in many other Latin American republics.

The rate of growth in output in Latin America is very high even when compared with the United States. Of course this phenomenon is partly attributable to the fact that the Latin American republics started their rapid rate of growth from a very low level of economic activity. At present there seems to be no indication that their rate of growth is slackening. It seems that the area has to some extent achieved the advantages of balanced economic development and will, therefore, advance equally on all fronts. Agricultural development will not be neglected in favor of industrialization.

An excellent example of the new trend toward balanced development can be found in Mexico's experience during the 1940-55 period. Argentina, on the other hand, has until recently been the typical representative of a relatively underdeveloped area trying to industrialize at the expense of agriculture. It might also be added that industrialization in each of the Central American republics would not constitute one of the most economical measures. The movement toward a Central American trading union is, therefore, a step in the right direction. Honduras

Table 2. Structural Growth, 1945-1955
(Billions of dollars, 1950 prices)

Industry	1945	1955	Percent increase 1945-1955
Agriculture	$ 7.5	$11.3	51
Manufacturing and building	7.0	12.4	77
Mining	1.3	2.1	62
All other	14.0	22.4	60
Total	29.8	48.2	62

Source: United Nations, *Economic Survey of Latin America,* 1955.

Table 3. Uruguay's Rate of Industrial Growth

Year	Value of industrial output in 1936 prices[a] (millions of pesos)	Real output (1936 = 100)	Average annual rate of growth
1936	$264	100	−0.9%
1937	260	98	
1938	258	97	
1939	255	96	
1940	255	96	
1941	262	99	3.3%
1942	277	105	
1943	288	109	
1944	318	120	
1945	297	112	
1946	336	127	10.1%
1947	348	131	
1948	471	178	
1949	484	183	
1950	536	203	
1951	506	191	

[a] Value of industrial output deflated by cost of living index on a 1936 base.

Sources: Ministerio de Industrias y Trabajo, *Memoria 1952,* p. 17; Banco de la Caja Obrera, *Uruguay's Outstanding Economical-Financial Information 1940-51,* p. 1; United Nations, *Hechos y Tendencias Recientes de la Economia Uruguaya,* Ch. 4, pp. 5 and 13; and United States Tariff Commission, *Mining and Manufacturing Industries in Uruguay,* p. 9.

and Guatemala have already signed a free trade treaty.[6] Regional coordination of production and trade in this area would yield maximum benefits, since the smallness of each individual market would render industrial production of each republic highly inefficient.

Conclusion

There can be little doubt that without the persistence of the Latin American governments in their protectionist policies, Latin America would today still be importing corned beef and canned soup, as some larger Latin American countries were doing only a few years ago and as some smaller ones are still doing. The fact that the area has doubled its industrial output over the pre-World War II period is to no small degree the result of its steadfast pursuit of industrial and commercial policies similar to those of the Uruguayan prototype — the pioneer of the industrial policy revolution in Latin America.

It might also be said that it is sensible and meaningful to evaluate the Latin American process of industrialization only in its historical perspective. Once a policy of protectionism and industrialization has been initiated, the return to commercial liberalism becomes very difficult at best, especially before the industrialization process is largely complete, a stage which would be difficult to determine. Also important in connection with industrial protectionism is the fact that Latin American development along industrial lines was started only after great industrial powers had already come into existence.

It is not suggested, therefore, that the end justified the means, but the rapid and successful development of Latin America during the past 20 years certainly suggests that a body of policies was followed that was not too far out of line with the best possible alternative.

With these considerations in mind, the present report should be considered as no more than an attempt to put the Latin American industrialization drive into its historical perspective and to explain its protectionist nature as it developed over time. It is not an attempt to assign a final value judgment to a process that is still under way.

[6] United States Department of Commerce, *Foreign Commerce Weekly*, December 10, 1956, p. 8.

Wage Policy in Britain: A Comment

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AN ARTICLE ON "Wage Policy in Britain" by Professor Frederick L. Ryan which appeared in the May, 1956, issue of *Current Economic Comment* seemed to the present writer to be somewhat misleading on a number of major issues, which are discussed in the following paragraphs.

1. Professor Ryan states that "until 1953 wages [in Britain] were chasing the cost of living."[1] This statement is valid only if "nationally negotiated wage rates" is substituted for "wages." As the accompanying table indicates, the average weekly real earnings of workers have been rising steadily since the end of the war. Wage rates negotiated at a national, or industry, level have been slow to pull away from the cost of living. This is reflected in wage rate indexes which are based on the easily obtainable records of national negotiations rather than on the wage rates actually paid at the factory. Earnings have been diverging from such national rates because of the habit of paying "plus" rates, because of earnings from payment by results schemes, and because of overtime payments. (Despite reductions in the length of the standard working week which were negotiated shortly after the war, hours worked by men today average rather more than they did in 1938.)

This distinction between wage rates and earnings is vital to an understanding of wages in Britain. The average worker's chances of an increased standard of living rest quite largely on payments over and above his negotiated wage rate. Moreover, it is the earnings

[1] F. L. Ryan, *loc. cit.,* p. 52.

Indexes of Wage Rates, Earnings, and Cost of Living in Britain

Year	Money wage rates	Average weekly earnings	Cost of living	Real wage rates	Real earnings
1938	100	100	100	100	100
1945	151	180	148	102	122
1947	169	203	163	104	125
1950	186	240	185	101	130
1953	228	301	228	100	132
1954	238	323	232	103	139
1955	254	342	238	107	144

Sources: The wage rate index is based on that given by Bowley in the *Bulletin* of the London and Cambridge Economic Service. The cost of living index is that calculated by R. G. D. Allen. It is based on the Ministry of Labor's index of retail prices after 1947, and from 1938 to 1947 is Allen's calculations based on the 1937/8 budgets collected by the Ministry of Labor. It is also published in the London and Cambridge Economic Service *Bulletin.* The earnings index is based on the six month earnings inquiries of the Ministry of Labor. The figures of wage rates and cost of living are annual averages except those for 1955 which are for April. The earnings figures are for October (except 1955). The wage rate and earnings figures are averages for both men and women.

figures which indicate the probable trend in the proportion of the national income going to wage earners — and earnings movements need not necessarily follow those of wage rates. For example the "wage freeze" in Britain in 1948-50 was more effective in controlling wage rates than earnings, which continued to rise.

2. Professor Ryan seems to give the general impression that the trade unions in Britain have been exercising a restraining influence on wage demands. It is probably true that "it was surprising . . . that the unions, in 1955, did not take greater advantage of the boom and ask for much higher wages than they did."[2] Throughout the postwar period the unions have never seemed to use the strong bargaining power implied by a sellers' market for labor to its full possible limits; but this does not mean that moderation has been advocated to the point at which wage demands have not contributed to inflationary pressure on the economy. True, the Trades Union Congress has built up a reputation of advocating restraint in wage demands, and many union leaders have made public statements showing their awareness of the dangers of wage-induced inflation. But, the TUC is not a wage-negotiating body, its powers over its members are very limited, and in this sphere direct powers are nonexistent. Further, trade union leaders do not always carry out their public pronouncements in their detailed duties, and are in any case influenced by the wishes of their members, who are less concerned with the long-term state of the economy than with their own immediate prospects. The nearer they get to the wage-bargaining table the less wage restraint remains in the minds of trade unionists. The "regular, yearly demand by the unions for an increase in money wages,"[3] which Professor Ryan mentions at a later point, is much more typically the union attitude than "the long-run rise in real wages . . . and not an immediate increase in money wages"[4] which Professor Ryan suggests to be the policy of union leaders. Moreover, the yearly increase seems to bid fair to become a habit which is unrelated to the state of the economy.

3. Professor Ryan attributes the inflationary pressure of 1955 to "the role that government spending played in adding to the total investment" and to "private investment spending"[5] and not to wages. In fact "total current expenditure on goods and services by public authorities fell slightly in real terms in 1955,"[6] while the amounts spent on new dwellings and social services (the main items in fixed capital formation by central government and by local authorities) were less in real terms in 1955 than in 1954.[7] Undoubtedly, however, investment in the private sector did rise markedly in 1955. Total fixed investment increased in real terms by 7½ percent in 1955 as against 1954 despite the fall in public investment in

[2] *Ibid.*

[3] Ryan, *loc. cit.*, p. 57.

[4] Ryan, *loc. cit.*, p. 53.

[5] Ryan, *loc. cit.*, p. 57.

[6] *Economic Survey 1956* (Cmd. 9728), p. 10.

[7] Cf. *Economic Survey*, Table 3.

housing and social services.[8] Moreover, stockbuilding was "£210 mn. greater in 1955 than in 1954, largely as a result of the increase in stocks and work in progress held by manufacturing industry."[9]

This increase in investment by the private sector was without doubt the new (and somewhat unforeseen) factor that pushed up inflationary pressure in the British economy in 1955, but wages cannot be absolved from blame in 1955 (and probably not in any postwar year). Between March, 1955, and May, 1956, retail prices rose by 7½ percent and wage rates for men rose by 11 percent.[10] In manufacturing industry, "whereas in the two previous years output per man-year is estimated to have risen at the same rate as annual earnings per employee, in 1955 output per man-year appears to have increased by only 4 per cent., while earnings rose by 8 per cent."[11] The total amount of wages and salaries paid out in 1955 was some 8½ percent larger than in 1954[12] whereas the increase in the quantity of goods and services produced by the home economy (gross domestic product) measured at 1954 prices amounted to no more than 3½ percent.[13] These figures all suggest that while increased private investment spending was a new and important factor in the generation of inflation in Britain, it is not a "mistake," as Professor Ryan would have us think, to believe that wages were an important cause of excess spending in the British economy in 1955. In fact the wage and salary bill increased by some £770 million in 1955, and investment (both fixed and in stocks) increased by about £400 million at 1954 prices.[14] Since both these increases had to come out of an increase of the gross domestic product of about £520 million at 1954 prices, and since an adequate increase of savings was not likely and did not occur, some degree of inflation in 1955 was inevitable — but the contribution of wage increase to this result was quantitatively greater than that of investment.

[8] Cf. *Economic Survey,* p. 9. Nationalized industries, of course, take up quite a high proportion of gross fixed investment (probably about a fifth to a quarter). The increase in their investment was, however, only about 5 percent. The increase in private fixed investment only (not government, local authority, or nationalized industry) was probably as great as 20 percent.

[9] *Economic Survey,* p. 10.

[10] Calculated from the Ministry of Labor's wage rate index and the interim index of retail prices.

[11] *Economic Survey,* p. 19.

[12] Cf. *Economic Survey,* pp. 10 and 11.

[13] Cf. *Economic Survey,* pp. 7 and 8.

[14] Derived from *Economic Survey* estimates.

Wage Policy in Britain: A Reply

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I am grateful to Mr. D. J. Robertson for his criticisms of my paper. I am inclined to agree wholeheartedly with his remarks, though I cannot agree that my observations on various issues were "misleading." I found in Britain in 1955 a quite general attitude that wages were the sole cause of the inflation; that state of mind I believed "misleading" and "mistaken," a judgment that has since been proven to be correct, as is abundantly shown in the *Economic Survey of 1956*. As Mr. Robertson knows, statistics on prices, wages, production, investment, and employment are at best indicators only, and arguments based on them should not be pushed too far; although he presents a different table, base, and components, I am unable to see that it vitally affects my conclusions. The additional "earnings" are paid for additional production in most cases, and should not be inflationary. I am aware that the TUC does not negotiate wages, but its powers of persuasion are considerable.

I was acquainted with the Cambridge Economic Service statistics, and the revisions of them by Professor Pigou. The use of indexes of average weekly earnings instead of average weekly wage rates by Mr. Robertson brings up again the perennial argument about which wage statistics to use when we are seeking to measure real wages. It is perfectly clear that weekly earnings statistics are available because they are collected regularly by official sources, whereas weekly wage rates are reported infrequently and from scattered sources. Even so, it seems to me that there is a fatal flaw in the use of average weekly earnings as one factor in the measurement of real wages, since there is included in weekly earnings some of the conditions that we are seeking to measure. The basic question is, How well off are the wage-earners in terms of goods and services, in relationship to the hours and to the speed with which they customarily work? Average weekly wage rates give the basic relationship, i.e., the weekly pay for the standard hours worked, and for the product associated with the standard conditions. But average weekly earnings may vary considerably from these basic relationships; earnings may be higher due to overtime work, incentive pay, bonuses, and so on, in most cases representing extra effort, extra speed, added responsibility, a sacrifice of leisure. The measurement of real wages should, I think, be based upon the standard hourly wage rate. Otherwise, an incorrect estimate is given of the labor costs in relationship to the purchasing power available to labor.

Books Reviewed

The Employment Act, Past and Future: A Tenth Anniversary Symposium. Edited by Gerhard Colm (Washington: National Planning Association, 1956, pp. xii, 203. $2.75)

This symposium is an illuminating collection of statements by "leaders in national life" who have had an interest in the passage or administration of the Employment Act of 1946, and brief essays by economists on "crucial issues of economic stabilization." The statements naturally reflect the aspirations or the particular specialties of the individual spokesmen, and while the points of view are conveniently brought together here, they are generally well known to the informed reader. This is apparent from a random selection from the 18 names represented, for example, Meyer Kestnbaum, George Meany, Walter Reuther, Leon Keyserling, and Senators Murray, Flanders, O'Mahoney, and Douglas. Nevertheless, scattered throughout these statements is a wealth of factual information and opinion which has hitherto not been easily available, and which in general well repays reading. It is an interesting and useful editorial device to furnish capsule summaries of information that would largely escape all but those who have made an intimate study of the history of the act.

The essays fulfill a different function. They indicate the nature of the problem of reconciling economic stabilization with growth by assembling the many different points of view held by a large number of experts. The diversity of subject matter is indicated by a glance at some of the contributions, again selected at random: the role of agriculture (Karl Fox), the attitude of labor (James Tobin), economic forecasting (Paul Samuelson), business spending (Neil Jacoby), statistical needs (Stuart Rice), the role of depressed areas (Joseph Fisher), international aspects (Jacques Polak), and political implications of a full employment policy (Elmo Roper). A useful summary of statements on employment policy issued since 1940 by international organizations and foreign countries is provided by Theodore Geiger. In addition the symposium contains a joint statement by the NPA on economic stabilization under the act, and a report on a survey of opinion within the Association with respect to the act.

The usual editorial disadvantages attend the inclusion of a wide range of opinion within the space of 200 pages. There is much reiteration of ideas, and some repetition of factual material. But it is important to call attention to the reader's dividends. These include a sense of the many factors involved in the achievement of maximum growth with minimum instability; the multiplicity of stimulating generalizations scattered throughout the book, which form a rich source of topics for further research as well as a challenge to the reader to strive to fit diverse opinions and points of emphasis into his own conceptual framework; and the opportunity to view many (though by no

means all) of the strategic factors in the maintenance of growth and stability in different lights and from various angles.

It would be almost invidious to select any particular contribution for critical comment, and the reviewer is rescued by the opportunity to comment on the NPA's own "Joint Statement on Economic Stabilization under the Employment Act: Past and Future." Interest centers here in the recommendation (originally made in 1954) that "economic projections" be made, on a six-year basis, which, though not forecasts, would provide the information necessary "for considering the possible need for adjustments in private business plans, in wages, consumer attitudes, and in government policies in order to promote balanced economic growth in line with rising productivity" (page 83). The projection would be revised annually after the first year.

No one would wish to take exception to the praiseworthy objective of providing all sectors of the economy with as much statistical information of this sort as possible. Clearly it is socially advantageous to know what rise in "total production, income, consumer expenditures, business investments and similar data" is needed in order to approximate full employment (page 82). Desirable as this objective is, however, one may suggest that something more is needed. The implication that better statistical information facilitates private planning, thus reducing the tendency toward increased central planning, assumes that private groups will use their knowledge in the interest of stability. This does not necessarily follow, and to the extent that it does not, "better" private planning might have to be associated with more central control rather than with less. Possessed of better statistical information, the more strongly organized groups would fight for their economic advantage with sharper weapons, and the result might well be an increase in administered pricing and a growing tendency toward cost inflation.

A final point: it is difficult to see how the various claimants to national product could overlook the fact that even a projection, if taken seriously, prejudices or ignores the incessant struggle that goes on for relative shares. For example, an assumption has to be made on the proportion of national income consumed. Thus the political implications of the "economic projection" also need to be worked out. But these are minor comments on a very stimulating collection of essays.

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Economic Needs of Older People. By John J. Corson and John W. McConnell (New York: Twentieth Century Fund, 1956, pp. xvii, 533. $4.50)

The fourteen chapters of this study are mainly concerned with the primary need of the aged — sufficient income. Although the authors are aware of other needs, such as medical care, housing, recreation, and a satisfactory social life, it is their assumption that the basic problem of the aged is one of adequate economic resources.

The volume is more a comprehensive survey and analysis of existing data on the economic status of individuals 65 years of age and over than a source of original material. It thus brings together information which has heretofore been scattered in many publications. Indeed, this is one of its major contributions of greatest appeal to any person interested in the problems of the aged.

After an introductory section on the place of older persons in our society, the authors examine the various income sources of the aged with particular reference to their adequacy and their national significance. In spite of the emphasis on pensions in recent years, employment still is the largest single source of income for individuals 65 and over. At the same time, a popular belief to the effect that increased employment of the aged can assist in overcoming the projected deficiency of persons of working age (14 to 65 years) during the next decade or two is shown to be a misconception.

Although not concerned with the specific details of private and public pension plans, the study does analyze their present coverage and deficiencies as well as their possible future pattern. It concludes that private pension plans are needed to supplement social security benefits for workers earning more than the current maximum on which Old Age and Survivors Insurance payments are calculated. It is the further opinion of the authors that the economy can afford a comprehensive, adequately funded private pension program for this purpose, assuming the present level of defense and foreign payments, at an estimated cost of 6 to 8 percent of payrolls.

The failure of the social security system to destroy the incentives of workers to make supplementary private provisions for the future is clearly shown by the growth in insurance and other self-protection systems since 1934. Corson and McConnell seem convinced that public and private pensions will never make personal savings unnecessary. Indeed, they indicate a belief that a free enterprise economy should assure a worker only a certain minimum retirement income through social security in order to give encouragement to personal savings.

The general conclusions of the study with respect to the future provision of adequate income for older persons involve some expansion of the OASI program as well as private pension plans. Since publication of this volume Congress has moved favorably in the direction of at least two recommendations of the authors on OASI — establish benefits for the disabled and lower the eligibility age for women. As yet, however, the other recommendations concerning automatic adjustments to enable benefits to keep pace with price changes and to extend coverage to certain additional groups of workers have not yet been given official implementation.

A unique aspect of this study was the appointment of a distinguished Committee on the Economic Needs of Older People to review the findings of the authors. The results of its work constitute the final chapter of the book. In

addition to formulating policy proposals concerning Old Age and Survivors Insurance and Old Age Assistance, this group pointed out areas for further study. The latter included (a) the desirability and possibility of providing tax exemptions to encourage saving for retirement and (b) the effect on the over-all fiscal system of changes in the tax position of private plans which would encourage both managers and workers to accumulate savings for employee retirement.

The outstanding task performed by this volume is bringing together existing information on the economic needs of persons 65 or over reveals significant gaps in the current data in this field. An up-to-date, national study and analysis of the status of the aged from a broader-than-economic point of view appears to be very much needed. In this connection, however, the comprehensive regional survey of the aged in California, published by a group of social scientists in 1954,[1] seems to have been overlooked by the authors. It contained a number of interesting comparisons and checkpoints of value for a study such as the one under review.

A few of the incidental statistics that are quoted might be subject to some argument but the criticism is minor and does not necessarily reflect errors made by the authors. In summing up the value of this publication, the statement on the dust jacket bears repeating, to wit: "Any person, in a public or private capacity, who is interested in any phase of the pressing problem of older persons in our society — or in his own future — will find this book an invaluable source of authoritative and useful information."

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[1] Floyd A. Bond and others, *Our Needy Aged* (New York: Henry Holt and Company, 1954).

Economic Growth and Instability. By D. Hamberg (New York: W. W. Norton and Company, 1956, pp. 340. $4.00)

In recent years, the economist has rediscovered the importance of a matter which the businessman ordinarily takes for granted, namely, that additions to capital are characteristically undertaken because such investment is expected to add to output. Thus, in a prospering economy where investment is continuously taking place, output or real income should continuously rise. This is undoubtedly the most important prerequisite for economic growth, at least as economic growth is defined by a rising standard of living.

Unfortunately in the real world, economies are not always prospering, nor is the standard of living always rising. It is the contradiction between that which seems economically possible and that which is actually achieved which perhaps as much as anything gives rise to Hamberg's *Economic Growth and Instability.* The author attempts with considerable success to integrate the Schumpeterian analysis of innovation with contemporary business cycle and employment theory based on the Keynesian model. Growth and instability are viewed as inseparable problems.

Instability as seen by Hamberg is the result of a failure of investment *contin-*

uously to fill the gap between consumption and a full employment level of income. This is complicated by the acceleration principle, whereby the sensitivity of investment to changes in income tends to accentuate fluctuations in the level of income.

The author is thus compelled to examine the statistical evidence as to the value of two strategic parameters in his model, namely, the marginal propensity to save and the accelerator. With respect to the first of these, he concludes that in the short run roughly 40 percent of incremental income is ordinarily saved (out of national income). With respect to the second (i.e., capital requirements per unit of output increment), he observes ". . . we have found the evidence to be strong that the (annual) accelerator is likely to be in the neighborhood of 2 or less" (p. 286).

If these values are both pertinent and correct, movements in national income are unlikely to be of a steadily explosive nature. Anti-damped cycles are also unlikely because of the limits set by depreciation on the rate of *dis*investment. "That an economy can withstand the impact of such inventory recessions as those experienced by the United States during the twenties and again in 1948-1949 and 1953-1954 without tumbling into a major depression would appear as impressive testimony to the *stability* of the economy" (p. 309).

In the explosive model of Hicks (which the author rejects) the cumulative nature of expansion and contraction is prevented from literally shaking the economy to pieces only by the constraints of a ceiling and a floor. In Mr. Hamberg's view, "The hallmark of a crisis engendered by collision with the growth ceiling would undoubtedly consist of sharply rising prices and wages just prior to the upper turning point. Neither of these phenomena has been present at the upper turning points of major cycles in the last eighty years (or more)" (p. 287).

It is perhaps not too much of an oversimplification of Mr. Hamberg's views to say that the exuberance of prosperity is brought to an end more by exhaustion than by impact with an impenetrable ceiling. The exhaustion in question is one of potential improvements. Thus, in true Schumpeterian style, it is the "basic irregularity of innovational investment" which gives rise to both instability and lapses from the long-run growth path. It is in the development of this theme that Dr. Hamberg makes his greatest contribution.

Although very little is said in the book about the lower turning point, one might presume that Mrs. Robinson's views on the subject would not be out of place: "It seems to me that the most plausible theory of the revival is Mr. Macawber's: given time, something will turn up. That is to say that a depression will not last forever because some fresh opportunity for investment is bound to present itself sooner or later."

For the professional economist there is a great deal more in the book than is indicated here. Mr. Harrod's model, for example, is elucidated and expanded; various obstacles to growth are commented upon and the problem of lags is discussed at some length. Although the book is generally well written, it contains very little that is star-

tlingly new. This may tend to confirm one's suspicion that this is a field in which pure theory can go but a limited way without massive assistance from the historian and the statistician.

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Can Prosperity Be Sustained? By Neil H. Jacoby (New York: Henry Holt and Company, 1956, pp. xiv, 152. $2.25)

When a recently retired member of the Council of Economic Advisers publishes a book called *Can Prosperity Be Sustained?* we expect something new — not necessarily a research contribution but at least some insight into the inner processes of government, the difficult decisions which must be made, or the problems of an academic economist who temporarily finds himself not far removed from the President's ear. This book is a disappointment. All it has attempted is "to deal with the large questions, briefly and simply" (p. vii). All it has achieved is to restate the Administration's position.

The book has some merit as a piece of exposition. It also has merit, from the point of view of those who agree with Jacoby and the Administration, as a vehicle of persuasion. Unfortunately, the second merit (if it be one) is bought to some extent at the expense of the first. Too often easy answers are given to questions which from the point of view of research ought to be regarded as unsettled and from the point of view of exposition ought to be clearly labeled controversial — a procedure which at the semipopular level of this book persuades the uninitiated by concealing from him the arguments on the other side.

Part I briefly recapitulates the past performance of the American economy, puts the goal of full employment in proper perspective, discusses the roles of government and the individual in maintaining prosperity, describes the Federal machinery available for managing the economy, and reviews the problems of forecasting. Part II gives Jacoby's program for the future: social security should be extended as a way of encouraging people to be more enterprising; the government should undertake public works which are complementary to private investment; monetary policy in the short run should be anticyclical and in the long run should aim at an average increase in the money supply of 3 or 4 percent a year; as the growth of the economy permits this to be done without unbalancing the budget, taxes should be reduced and reformed to stimulate private enterprise, the reductions being timed to maximize the countercyclical effect; the government should take a variety of measures to encourage invention and research and thus stimulate business investment; and it should maintain vigorous competition, an end which is achieved not only by enforcing antitrust laws and avoiding government encouragement of monopoly but also by all the other measures advocated to stimulate private enterprise and economic progress. There is also a chapter on foreign economic policy.

Jacoby is a cautious optimist. His faith is compounded of belief in the inherent vigor of private enterprise, in

the efficacy of monetary policy, and in the power of fiscal policy. He appears aware of the danger that the rise of a generation which was too young to feel the impact of the thirties will lead eventually to carelessness in government and recklessness in business, which could beget another debacle; but he implies that modern research can overcome any danger of even temporary depletion of investment opportunities.

Such cautious optimism is not only appropriate to our times but is also the attitude best calculated to maintain prosperity. From a scientific standpoint, however, it should be recognized that the optimistic thesis has not yet undergone a rigorous test. The crash of 1929 occurred 11 years after the end of World War I, precisely the interval between the end of World War II and publication of Jacoby's book. Given such historical differences between the two situations as the greater backlog of investment opportunities in 1945 than in 1918, the lesson which the thirties taught businessmen about the consequences of reckless behavior, and the impact of the cold war, it would be reasonable to expect a longer period of sustained prosperity than that of the twenties. The real test is yet to come.

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An Expenditure Tax. By Nicholas Kaldor (London: George Allen & Unwin, 1955; New York: Macmillan, 1956, pp. 249. $2.75)

What is the most appropriate measure of taxpaying capacity — income or expenditures on consumption? For a century, income has typically been regarded as the preferable measure. The defenders of the expenditures basis have consisted of two groups. The first group, in the desire to lessen progressivity of the over-all tax structure, favored the attainment of the expenditure measure through the medium of the sales tax. The second group — relatively few in number but including some very distinguished voices, such as those of John Stuart Mill, Marshall, Pigou, and Irving Fisher — preferred, as a matter of principle, the imposition of an expenditure tax upon individuals. However, members of this group (except for Fisher) regarded this as impracticable and accepted the income basis as a second-best alternative. The first group has exercised little influence on tax policy because their ulterior motive was so obviously in conflict with accepted standards; most of the members of the second group were themselves unwilling to argue for the use of the base which they preferred, and their arguments for the theoretical superiority of the expenditure base were clouded by their emphasis upon unconvincing terminological considerations (the notion that taxation of income involved double taxation of savings). The few actual proposals in the United States for a spendings tax (by Ogden Mills in 1921, by Fisher, and by the United States Treasury in 1942 as a temporary wartime measure) received no serious consideration, although the work of Fisher and the Treasury in the early forties led to the conclusion that the spendings tax was not absolutely impossible of administration, as earlier supporters of the

principle had feared. Nevertheless, any supporter of the principle that the expenditure basis is superior has been suspected of favoring a sales tax and less progressive distribution of burden, or of ivory-tower support of a visionary and impracticable levy.

In *An Expenditure Tax,* the eminent Cambridge economist Kaldor has succeeded in making the expenditure proposal respectable. He has presented the strongest and most carefully reasoned case for the expenditure basis thus far made, a case strengthened in its appeal to many persons by the fact that he is so clearly committed to the principle of progressive taxation and does not favor the expenditure basis merely as a means of reducing progressivity.

Kaldor's basic thesis is the argument that only the expenditure basis, attained by a direct annual tax on total consumer expenditures less deductions, can allow the realization of the twin goals of preventing excessive inequality of income and achieving a high rate of economic development. Only this basis allows the taxation of persons according to the drain which they make upon national output rather than the contributions which they make to national output. More specifically, the defense of the expenditure basis is made on several grounds, which can be summarized only briefly:

(1) From the standpoint of equity, the expenditure basis avoids the inherently difficult problem of defining income for tax purposes in such a manner as to make it an adequate reflection of spending power. Dollars of income do not represent equal sums of spending power, because some income is regular and other is irregular; some is received from labor, other from property. Capital gains represent a very significant source of income, yet they are completely tax free in Great Britain and receive favorable treatment in most countries, and any attempt to ensure equal taxation of such gains and other income encounters the fundamental problem that capital gains from various sources represent widely differing spending capacity (for example, those resulting from price or interest rate changes reflect different capacity than those from other sources). Present tax laws are very ineffective in placing various incomes onto a common denominator of spending capacity; although a better job could be done, the task is fundamentally a difficult one. With the expenditure basis, the individual performs the task himself when he decides how much to spend on consumption. The regressive relation of consumer expenditures to income can be offset by the use of adequate progression in the rates of the expenditure tax.

(2) From the standpoint of savings, the expenditure basis would eliminate the incentive given by present income taxes to spend more and save less. For persons in the high income brackets, the present sacrifice of consumption necessary to increase the annual flow of income is tremendous; the sacrifice in after-tax annual income which results from current dissaving is very slight. The expenditure tax would eliminate this bias, since amounts of income saved would be free of tax, whereas dissaving would give rise to tax liability.

(3) The expenditure basis would

eliminate the present discrimination of the income tax against risk taking, a discrimination which would be much greater if capital gains were taxable. The present capital-gains safety valve is highly inequitable, however, and encourages speculation, as distinguished from investment in business expansion.

(4) The expenditure basis has less advantage relative to incentives to work, but would have less adverse effect than the income basis in the case of irregular incomes and marginal work.

(5) The use of the expenditure tax would allow the elimination of the present corporation tax designed (in Great Britain) primarily to reach undistributed profits in lieu of a tax on capital gains. The present corporate tax is injurious to business development, is distributed in an inequitable fashion among various persons, and over a longer period may easily shift forward to consumers through higher prices and thus higher before-tax yields on securities. The expenditure tax will reach individual expenditures made on the basis of the increase in the value of company stock holdings.

(6) The expenditure tax is a more effective instrument of fiscal policy. Its "economic efficiency," or anti-inflationary effect per dollar of revenue, is clearly greater than that of the income tax, which is absorbed out of savings to a larger extent. Thus the rate of the latter tax must be greater to attain a given deflationary effect, with consequently greater adverse effects upon production. From a long-run standpoint the expenditure tax will allow a higher rate of capital formation and economic development, as the tax will be borne to a greater relative extent at the expense of consumption.

The last section in the book is devoted to the question of the practicability of the tax. Taxpayers would be required to ascertain the annual net change in their wealth holdings, in order to determine the net amount saved during the year. This figure subtracted from income would give the figure of consumption expenditures, without the recording of actual expenditures made. Special provisions would be required for purchase of expensive consumer durables and for treatment of gifts and bequests, and a system of personal exemptions based upon the size of the family would be desirable. Special allowances might be made for certain unusual expenses (for medical purposes, for example). Kaldor regards these problems as capable of solution. But the greatest stumbling block to the general use of the tax in Great Britain would be the requirement that all taxpayers file individual tax returns showing total income (and consumption), which many do not do under the present income tax collection procedure. He concludes, therefore, that initially it is not feasible to replace the income tax (exclusive of the surtax) by an expenditure tax, but argues that it is not particularly necessary to do so, since for the average worker, subject to lower tax rates and having little discretionary saving, the expenditure basis is not significantly better than the income tax.

Instead, he recommends the replacement of the surtax (technically a levy distinct from the income tax in Great Britain) by an expenditure tax. This

would limit the number of persons required to file returns to a tolerable number and would allow the attainment of the advantages of the expenditure tax in the higher income levels, in which they are greatest. Persons in these income ranks suffer the greatest discrimination under the present tax, and are given the greatest incentive to curtail savings and avoid risk taking.

Although administration of the expenditure tax would probably be simpler in the United States than in Great Britain because of the widespread individual return system, the relative advantages of the change are not as great. The British surtax rates reach much higher levels at moderate income figures than do ours; capital gains are not taxed at all, with consequently greater discrimination in favor of certain groups; a higher rate of capital formation is probably more necessary if Britain is to retain her place in the world economy; the pressure toward inflation and the adverse effects of inflation with respect to world markets are greater; and there is probably a larger group of persons inclined to maintain consumption levels despite tax by dissaving. Nevertheless much of Kaldor's reasoning is equally applicable to both countries. Kaldor's thesis obviously reflects the long-continued background of inflationary pressures and excessive consumption which have characterized postwar Britain; it could scarcely have been developed in the thirties. Little attention is given to the adjustments in the tax which would be necessary in a depression; positive action to minimize the effect of the tax in curtailing consumption would be essential, and might not be forthcoming. The weakness of the income tax as an anti-inflationary measure stands it in good stead in a depression; the expenditure tax offers less built-in flexibility and greater dangers from failure of governments to act promptly. Kaldor has not considered the problems of the effects, psychological and otherwise, of the growth of the national debt which would occur if the greater anti-inflationary effect of the expenditure tax made necessary a continuing budget deficit in order to prevent toppling the economy from inflation into depression. He has by no means met all of the administrative problems, particularly that of distinguishing between consumption and business expenditures, which would be even more serious than under the present income tax.

Despite these limitations, this book is one of the most significant volumes to appear in the field of public finance in several years. Building on the work of Fisher, Vickrey, Poole, Friedman, and others, Kaldor has taken a major step forward in the direction of reorientation of thinking on the question of income versus expenditures as the appropriate measure of taxation. In the foreseeable future, problems of inflation and excessive consumption relative to the level which will permit adequate capital formation without inflation appear inevitable, and the expenditure tax warrants much more attention as a tool of fiscal policy under such conditions than it has thus far received. Kaldor's book is a major step in this direction.

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Public Control of Economic Enterprise. By Harold Koontz and Richard W. Gable (New York: McGraw-Hill, 1956, pp. xii, 851. $7.00)

The authors of this massive volume devote considerable attention to topics such as labor, financial organization and policy, and general stabilization policy, in addition to the usual subject matter of this field (antitrust policy, transport and utility regulation, public aid to and ownership of business). Conservation policy is not discussed, although in terms of common curriculum organization and the usual microeconomic focus of courses in public control it would be more appropriate than concern with monetary and fiscal policies designed to stabilize the economy. The volume is satisfactorily organized around broad areas of control (e.g., transportation, maintaining competition, protecting the investor, labor), although its organizational principle does not have the useful integrating properties of the schema used by Wilcox in his *Public Policies Toward Business.* It is well written, and a number of topics, such as public ownership and labor, are particularly well handled, but it does not possess qualities of style, organization, or insight that might cause one to lose sight of the fact that it is a textbook.

Public Control of Economic Enterprise is primarily descriptive in content, with analysis kept at a minimum. When the authors venture into deeper waters they thrash about clumsily (on price discrimination, pp. 108-10, or basing points, pp. 401-05), and occasionally go down for the third time (where employer exploitation of labor is alleged to be "not only unscrupulous, but foolish. If he can get labor at a price below its productivity, his most profitable course would seem to lie in hiring more of it until the marginal product of labor just equals its wage" [p. 489, n. 2]).

The number of errors of fact and judgment in this volume is disturbingly large. It is not reasonable to describe the state and Federal antitrust laws passed between 1887 and 1914 as reflecting "a vigorous legislative policy to break these combinations into competitive parts" (p. 13). With no serious qualification the authors assert that "The obligation of a contract is impaired when its value has been diminished as a result of legislation," citing a judicial decision of 1848 as controlling (p. 44; cf. Wilcox, p. 42). The authors assert at one point that prior to the Transportation Act of 1920, regulation of the railroads was "primarily punitive in nature"; shortly thereafter they state that "It has been well said that the Commission's role and the basic purpose of the law is 'to make the transportation system as a whole function as an impartial service agency for the national economy' " (pp. 76, 115). It is not true that "Where every producing point is a basing point, the system becomes merely one by which the sale price is the delivered price to the purchaser," and the 1948 Cement Institute decision did not declare that "freight absorption, as well as phantom freight, was illegal under section 2a of the Clayton Act" (pp. 401, 405). It is also misleading to say that the Federal Reserve Banks "are managed much like other banks," and that they "regulate interest rates of member banks" (pp. 420, 421).

More serious deficiencies are too often found in the authors' framing of issues and general handling of important policy questions. Thus, despite the brevity and superficiality of their review of the major issues connected with patents, the authors do not hesitate to conclude that modification of the patent laws would be undesirable (p. 607). In discussing some of the dangers involved in administrative regulation Koontz and Gable state that "The unfair baiter of business is as dangerous as the influenced conniver with business. Moreover, since regulatory agencies are generally regarded as protectors of the 'public,' particularly the organized pressure groups of the 'public,' there is likely to be a bias in its favor at the expense of the less effectively organized business manager" (pp. 59-60). Elsewhere the authors state that "the consuming public, as a highly interesting group, is seldom represented in the councils of law-makers" (p. 183). These contradictory assertions exhaust their discussion of a controversial issue which is basic to any adequate appraisal of public regulation. Similarly, the authors advert several times to "the self-generating tendency of controls to expand," but no mention is made of the rôle played by vested interests desirous of escaping competition in forwarding this process. This self-generating tendency is explained by Koontz and Gable in terms of "the natural desire of the public [earlier noted to be "seldom represented in the councils of law-makers"] and legislators to fill the gaps in government control policy and to accomplish the ends sought by it" (pp. 96, 817).

Thus, despite quite satisfactory and even superior treatment of a number of issues, *Public Control of Economic Enterprise* is too spotty and shallow to merit a rating within the highest class of books in its field.

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The Failures of Economics: A Diagnostic Study. By Sidney Schoeffler (Cambridge: Harvard University Press, 1955, pp. xiii, 254. $4.75)

This book purports to explain the "whys and wherefores" of what it styles the "failures of professional and academic economics" (pp. 1-6) and the "malpractices of economic analysis" (pp. 39-41). These failures arise out of the use by economists of concepts and "investigative tools" picked up "already at hand" because economists are not disposed to do their own "tool-constructing" (pp. 17 ff.). Thus it is that economists tend to characterize real behavior through mechanical models which leave out its vital tendencies ("artificial mechanization"). This behavior is allegedly carried on by similarly structured and motivated agents which are thus artificially simplified. The purely empirical relationships discovered to prevail in past behavior have been unwarrantedly projected into the future, thus presupposing invariance in fundamental conditions ("artificial generalization"). Objects which are not readily classifiable are artificially grouped together. Aggregative relationships are reduced to structural equations which are not left open but are closed in order to be solvable.

These are the major items in a "catalogue" of "weaknesses" which,

though admittedly overlapping, are illustrative only. These weaknesses are illustrated by a series of case studies which make up a major part of this little book. The case studies chiefly involve applied statistical or econometric research in which Keynesian NBER and econometric practitioners are called to account for their sins of omission and commission. The predominantly critical text is supplemented by a few pages of positive analysis intended to help economists reorient their thinking in the needed directions.

In the main, this analysis reduces to reciting the semantics of an ambitious scheme for a metaphysics of science applicable to all sciences dealing with human action in any form. So far as it concerns economics, the positive suggestions boil down to the prosaic conclusion that economic systems (defined as virtually any complex of interrelated economic behavior) are "essentially open" (pp. 51 ff.), which appears to mean that operationally the system is not completely isolated or effectively insulated from its environment — an environment which is autonomously changing and historically evolving. Chiefly from this, Schoeffler concludes that economics is not and cannot be a science, but that it is an art; that one branch of this art is concerned with "how to decide upon the best course of action in any given set of specific circumstances"; that the other branch involves economic policy making which is distinguished from decision making by being applied to "a more concrete and specific matter" (pp. 154-61).

Most so-called economists are characterized as "historians" since they are not engaged in a search "for universal principles" (p. 163). (Are the decision makers or policy makers?) The elite economists remaining are advised to concentrate in large numbers on methodology (pp. 163 ff.). These profound though simple truths about economics and economists have been hitherto concealed from the world through the interminable controversies that economists have carried on because the controversialists, grouped under "empiricist" and "theorist" headings, lacked true insight. Hence, the truth had to wait for its full unfolding until one young man, Sidney Schoeffler, had the opportunity to study "methodology" at the New School for Social Research.

Detailed commentary on claims so bombastic and barefaced is not needed. There are many weaknesses in economic thought and in applied research, and Schoeffler has put his finger on some of them. But he does not present a full catalogue nor a very impressive analysis of those he does discuss. In any case, sweeping generalizations of the type presented are neither illuminating nor instructive. It is easier to prattle about "open systems" than it is to help in the laborious task of developing econometric analysis which arranges and utilizes our wealth of statistical information in other forms than standard tables, averages, and arrays. Schoeffler should remember economic predictions will at best have only approximate accuracy. The semantics of scientific research have been more impressively presented elsewhere.

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